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Routledge Encyclopedia of International Political Economy

Edited by R.J. Barry Jones

Volume 3: Entries P–Z



London and New York

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P

paradigm

Generally used as a synonym for 'example' or 'blueprint', the term 'paradigm' achieved great exposure and use throughout the sciences and social sciences from its focal role in the seminal work by Thomas Kuhn on the history of science – *The Structure of Scientific Revolutions* (1962). In this context, a paradigm comprised the working assumptions, procedures and findings routinely accepted by scholars in a discipline or subdiscipline, providing the stable core for their scientific activity. A scientific community was thus defined by its paradigm – by its shared culture of scientific practice: 'a scientific community consists of men [*sic*] who share a paradigm' (Kuhn, 1962).

By identifying the agreed philosophy, theoretical focus and methodological procedures within which scientific communities work, a paradigm comprises the context into which new scientists are socialized, hence Kuhn's observation that the contents of a discipline's paradigm are set out in its textbooks. The existing framework defines both what is accepted as knowledge and the procedures used to extend that understanding by the solution of new problems: for any scientist, their disciplinary paradigm provides accepted methods for problem-solution, so that training in the paradigm is what Barnes terms:

dogmatic and authoritarian ... it does not generate or encourage traits such as creativity or logical rigour; rather, it equips scientists so that it is possible for them to be creative, or rigorous, or whatever, in the context of a specific form of culture.

(Barnes, 1982)

This is what Kuhn calls 'normal science' – in which, for any piece of research,

everything but the most esoteric detail of the result is known in advance ... the aim of normal science is not major substantive novelties ... [instead] the results gained in normal research are significant because they add to the scope and precision with which the paradigm can be applied.

(Kuhn, 1962)

Among workers within a paradigm those who succeed prove themselves 'expert problem-solvers'.

The outcomes may not always be as predicted, however; some scientific experiments produce unexpected results. According to Kuhn, these are usually largely disregarded as anomalies which should not be deployed to divert the progress of normal science and throw doubt on the paradigm's veracity: either the experiment was badly conducted, or the results were wrongly interpreted, or some confounding circumstances were not taken into account/held constant. Some scientists may worry about the anomalies, however, and seek to accommodate them by revising the paradigm. This involves them in extraordinary research (as opposed to normal science) and an alternative paradigm, which can accommodate both the normal scientific findings and the anomalies, promotes a revolutionary episode during which scholars are invited to choose between the merits of the alternative paradigms on offer. If they accept the one that incorporates the findings of the extraordinary research, then a scientific revolution takes place – invariably, according to Kuhn, because of an intuitive leap of faith rather than the application of strictly logical

criteria. The revolutions which occasionally punctuate the progress of normal science – as with the Copernican revolution in astronomy and the Darwinian revolution in biology – are thus major events in scientific history that call scientists back to their hunches rather than to the application of rigorously analytical methods. (To Karl Popper such revolutionary thinking is the ‘real stuff’ of science: normal, routinized science is application rather than discovery.) Kuhn’s ideas had a major impact on scientists, historians of science and philosophers of science. Many, however, found his treatment of paradigms confused. Indeed, one critic identified twenty-one uses of the term in Kuhn’s book, which could be classified into three types distinguished by the scale at which they operate:

- 1 *metaparadigms* or *world-views*, consisting of the general organizing principles within which scientists operate (their shared epistemological and ontological concerns);
- 2 *sociological* or *meso paradigms* of *disciplinary matrices*, which comprise a community of scholars’ shared achievements and working habits – their accepted generalizations (perhaps their laws or theories) and their shared commitments to particular models or guiding frameworks for research, and
- 3 *artefact paradigms* or *exemplars*, which are the classic pieces of work on which subsequent research is based.

Of these, the first provides the general framework within which many sciences are conducted, the second is the context for a particular science (a discipline or subdiscipline) and the third provides the model for problem-solving.

Kuhn accepted much of this criticism in his later works, and claimed that his main interest was in the communities and subcommunities operating at the second and third levels. For him, scientists work by searching for analogies to the problems they have identified, for classic works (exemplars) which suggest how they should be tackled: they are the

concrete problem-solutions that students

encounter from the start of their scientific education, whether in laboratories, in examinations, or at the ends of chapters in scientific texts. To these shared examples should be added at least some of the technical problem-solutions found in the periodical literature that scientists encounter during their post-educational research careers and that also show them by example how their job is to be done.

(Kuhn)

In this context, a ‘revolution’ involves the switch from one exemplar to another, which may be crucial to scientific progress but not equivalent to the major changes in thought engendered by such people as Copernicus, Newton, Darwin and Keynes. Revolutions at the exemplar scale are relatively frequent; in the disciplinary matrix they are rare (because they involve changes in the orientation of a discipline, rather than the details of how its research is done) and in the world-view they are extremely rare (because these involve changes in the conception of what science is).

Kuhn’s notion of paradigms themselves and of revolutions as ‘paradigm shifts’ at one of three scales has been widely debated over the four decades since they were first mooted. They have also been applied widely in the social sciences, to which Kuhn thought they were irrelevant: most of those applications have been widely criticized within the social sciences. Nevertheless, the social sciences are practised by communities of scholars with shared cultures regarding the nature, aims and methods of what they do: their practitioners occasionally decide that one exemplar is superior to another and even change disciplinary matrices. But revolutions in those disciplines are unusual. They are best described as anarchies – agglomerations of communities that are usually only loosely defined, but have shared interests (and perhaps some institutional presence, such as learned societies and journals) – between which people may move according to their interests and whose size within the larger disciplinary matrix may wax and wane accordingly.

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RON JOHNSTON

paradox(es) of rationality

The adequacy of assuming RATIONALITY is the basis for choice by economic agents has been questioned and it has been argued that other motivations are important to the choices made by individuals – for example, habits, tradition, social norms, altruism or religious beliefs. However, even when rationality is acknowledged as an appropriate assumption for the development of theories about individual choices, paradoxes can occur within the resulting theoretical framework. These paradoxes are of two types: those that relate to the decision-making process by individuals and those that stem from the social context of the individual decision-maker.

When making rational decisions, individuals require information about the likely impact that different choices will have on their achievement of desired goals. Gathering information can entail the expenditure of time, effort and/or money. In some cases, an

individual may consider that the choice involved does not warrant the expenditure of time, effort or money in order to obtain the information that is necessary to form the basis for a 'rational' decision; instead, they may base their decision on another motivation, such as habit. This is, however, a 'rational' decision, because the individual is maximizing the use of their time, effort and money by not using it on seemingly minor choices. The apparent paradox is that rational individuals, maximizing the use of their resources, may use motivations other than rationality when making choices.

The second class of paradoxes arises because the RATIONAL CHOICES made by different individuals can impact on each other's ability to achieve desired outcomes. This is illustrated by PRISONERS' DILEMMA games, in which rational choices by two individuals minimize their ability to achieve desired outcomes, whereas apparently irrational choices can serve to maximize each individual's outcomes. That is, the achievement of particular goals may be best served by adopting strategies based on motivations other than the 'rational' pursuit of those goals. This may not merely be a matter of theory:

It has been argued that economic success has often come more plentifully in cultures that emphasize norms of conduct quite different from that of persistent maximization of individual self-interest, focusing [instead] on other values.

(Sen, 1987: 71)

In such cases, the generation of EXTERNALITIES by other decision-makers affects an individual's abilities to achieve desired goals.

Finally, paradoxes also arise when one attempts to aggregate individual choices to determine the 'social choices' of a group of people. This extensive area of theory (known as 'social choice theory') examines the difficulties associated with aggregating individual choices in a manner that meets certain basic, and seemingly undemanding, criteria. This area of theory was initially developed by KENNETH ARROW and further pursued by AMARTYA SEN.

parallel markets

Despite difficulties with the assumption of rationality as the motivating force behind economic decision-making, that assumption has made it easier to analyse complex economic questions. However, in attempting to simplify the analysis of economic questions, it seems likely that some significant aspects of economic behaviour are overlooked. The situation is well summarized in Sen's conclusion: 'The need to go beyond the existing literature is apparent enough, but where to go is less clear' (ibid.: 74).

See also:

public choice (PC) theory; post-rationalist international political economy

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THERESE JEFFERSON

parallel markets

Parallel markets are 'unsecured' short-term MONEY MARKETS – that is, money markets in which there is no LENDER OF LAST RESORT. This is in contrast with the traditional money markets, where the central bank operates as lender of last resort. Banks are the main institutions active in both traditional and parallel money markets, while the financial instruments traded are mainly represented by deposits or Certificates of Deposit (CDs).

The traditional London money market is represented by the market in treasury and commercial bills. In parallel with the traditional sterling money market, a secondary

sterling market (consisting of inter-bank, unsecured deposits) has developed from the 1960s onwards, together with an equally unsecured local authorities' market. The development of the Certificate of Deposit has also allowed for the establishment of a CDs market. However, the London EURO CURRENCY MARKET is by far the most prosperous and important of the short-term London money markets.

L.S. TALANI

Paris Club

The Paris Club is the forum in which creditor countries conduct negotiations with debtor countries to agree the terms and conditions for the rescheduling of official debt. The LONDON CLUB plays the same role for private creditors.

The Paris Club was formed in 1956 to enable creditor governments to react in unison to the problems being encountered by Argentina in repaying its debt. The secretariat is based in Paris, which is the location for all meetings; the meetings are usually chaired by a senior official from the French Treasury. The Paris Club has become a central institution for LESS-DEVELOPED COUNTRY (LDC) DEBT MANAGEMENT since the outbreak of the DEBT CRISIS in the early 1980s. All major creditor countries are members of the Club, Russia having joined in 1998. To be eligible to go to the Paris Club, the debtor needs the seal of approval of the INTERNATIONAL MONETARY FUND (IMF) – that is, the debtor has to be on an IMF-approved economic programme, which will usually include a schedule of debt payments in addition to economic policies deemed consistent with meeting debt obligations. A multilateral agreement (one covering all the Club's members) is reached and it will usually cover 100 per cent of members' outstanding official debt, though it is sometimes a smaller percentage. Frequently creditors will have a menu of options from which they may choose the particular terms for rescheduling (these menus being initially the Toronto and more

recently the Naples Terms). All creditors are treated equally (that is, none have preferred status in receiving repayment).

Lower-middle-income countries have been the main beneficiaries of the Paris Club's operations. From 1980–96, \$216 billion of lower-middle-income country debt was consolidated, compared to \$63 billion for low-income countries and \$31 billion for high-middle-income countries (though the share of the latter group has declined over time, being less than 10 per cent of the total in the 1990s).

The Paris Club may be labelled a creditors' cartel (see CARTELS), since it deals with each country on a case-by-case basis, undoubtedly increasing the relative bargaining position of the creditor against the debtor.

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HOWARD WHITE

patents

Economically valuable knowledge is conventionally divided into an idea (subject to patent) and its expression (subject to copyright). For patent, an idea should be:

- 1 *New*: It is not already in the public domain or the subject of a previous patent.
- 2 *Not obvious*: It is not common-sense to any accomplished practitioner in the field at that time or self-evident using available skills and technologies.
- 3 *Useful* or *applicable*: It must be a new or improved process or machine with a stated function.

If all these conditions are fulfilled, an idea can be patented; otherwise, another form of intellectual property protection may be appropriate, but not patent.

The history of patent since the British

Statute of Monopolies of 1623 exempted an 'inventor of a new manner of manufacture' from legal sanction, reflects the subsequent recognition that MONOPOLY rights of ownership in innovations require some dilution by political authority to ensure that certain social needs are fulfilled – most notably economic DEVELOPMENT. The patent is an explicit bargain between the idea's originator and the STATE, balancing ownership and disclosure. Ideas enter the free public realm when patents expire, having previously been available only on payment to the owner of a fee enforced by the state. However, what is patentable is not an uncontested issue: for instance, recently patents on scientific discoveries such as DNA strings or genetic matter (which have major implications for the development of the biotechnology industry) have become areas of heated international political dispute.

See also:

intellectual property rights (IPRs); knowledge industries; technology transfer

CHRISTOPHER MAY

patriarchy

The literal and historical meaning of 'patriarchy' is 'the rule of fathers'. Although there is no consensus on the contemporary definition of the term, many feminists have extended it beyond the realm of the family to include the rule of men over women more generally (see FEMINISM). Patriarchy so defined encompasses all systems of male dominance. Most feminists outside the liberal tradition claim that men dominate women through a variety of political, economic and social structures that vary across time and place. Since patriarchy is not seen as a universal state, but as a social construction, feminists believe that it can be overcome. Therefore, revealing and critically analysing patriarchy's various manifestations can contribute to ending it.

Liberal feminists have argued that forms of discrimination against women have decreased in many societies as legal barriers to voting and participation in the labour force have broken down. However, since forms of GENDER discrimination remain even after legal barriers are eliminated, other feminists believe that they can only be explained by the existence of a patriarchy that is sustained by patriarchal ways of thinking.

Patriarchal thinking is based on socially constructed gendered dichotomies such as reason/emotion, culture/nature, independent/dependent and public/private. The first term in each of these pairs is typically associated with men, the second with women. Such thinking has the effect of assigning women to reproductive and maintenance tasks in the private sphere. Based on a belief that women are closer to nature than men, these roles come to be seen as natural ones for women. Through the association of reason and culture with masculinity, men are able to transcend biological categories, thus legitimizing their predominance in activities in the public sphere.

This public/private distinction is integral to feminist definitions of patriarchy. Feminists assert that the separation of public and private spheres began in the seventeenth century, concurrent with the birth of modern states and capitalism. Modern state-formation marked a shift to relatively independent household units, legally headed by men; women became vulnerable and dependent on fathers and husbands. As the workplace became separated from the household, women were consigned to the role of housewife and men assumed the role of breadwinner. Even though many women have always worked, the notion of the family wage has meant that their wages have been perceived as supplementing men's, thus justifying women's lower pay. Since men's labour moved into the market, production has been seen as more important than reproduction. Feminists claim that understanding these public/private distinctions can help to explain the persistence of gender inequalities.

The privileging of the public over the private has led to the use of market models (such as

RATIONAL CHOICE theory) to explain the economic and political behaviour of individuals and states. Suggesting that the concept of rational economic man assumes characteristics that correspond to a socially constructed masculinity, feminists assert that women in their reproductive roles as providers of basic needs for families do not conform to the behaviour of instrumental RATIONALITY. Feminists claim that this has implications for liberal and nationalist theories of international political economy (IPE), both of which draw on rationalist models to explain and prescribe the behaviour of states and markets. Feminists also criticize Marxian theories for focusing on public-sphere activities and neglecting the private sphere of reproduction.

Feminists in the field of IPE believe that, if the reasons for the continued underrepresentation of women in positions of political/economic power and their disproportionately high numbers among the world's poor are to be adequately understood, the patriarchal underpinnings of states/markets and the theories that are used to explain their behaviour must be revealed, analysed and transcended.

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ter 3 critiques the major theoretical approaches to IPE from a feminist perspective.

ANN J. TICKNER

patronage system

The patronage system is an institutionalized arrangement in which politicians or prominent personages (notables) exchange material benefits for votes or obedience. It is a form of CLIENTELISM in which politicians or public institutions direct public resources toward a specific constituency or constituent in exchange for political support, with these exchanges a regular part of the political system. A more restrictive definition would limit the term to a system that distributes PUBLIC SECTOR jobs to supporters of a given party or politician. Some scholars have argued that patronage systems originate in and characterize underdeveloped or 'backward' economies (see UNDERDEVELOPMENT), where affective, personalistic ties are still important to deciding resource distribution; the implication is that the patronage system will disappear with modernization. Others point out that patronage systems survive and even develop during modernization. Contributing factors appear to be lack of market-based access to resources and the founding circumstances of a public institution. More controversial is the role of POLITICAL CULTURE in creating or furthering the environment in which a patronage system can develop.

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the historical and structural bases of patronage.

CAROLYN WARNER

Pax Americana

The term *Pax Americana* is generally taken to refer to the dominance of the United States, both economically and politically, in the international system of the post-World War II period. Such dominance arose as a result of the position that the United States found itself in at the end of the war in comparison to the other combatant countries. Whereas the latter were in a dire financial position, the United States was economically healthy and politically stable, with a strong currency. In recent years, however, the increasing GLOBALIZATION of the international system has meant that America's position as global hegemon (see HEGEMONY) has been questioned, leading many analysts to surmise that the era of *Pax Americana* has now ended. Others, however, suggest that the international system is still, to an extent, characterized by a *Pax Americana*, particularly given the collapse of COMMUNISM in Eastern Europe and the posited triumph of LIBERALISM that this collapse could be said to represent

See also:

dollar. US: hegemonic stability theory; Marshall Plan

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ALISON M.S. WATSON

Pax Britannica

Drawing an analogy with the *Pax Romana* (the peace imposed by the Romans within their empire), the British have long referred to a *Pax Britannica*. By doing so, they sought to draw attention to a range of benefits deriving from British rule: in addition to the restraint of violence, they included those (such as law and civil engineering) customarily associated with Rome. The phrase simultaneously drew attention to and in some measure legitimized the forcible character of a peace created or maintained within formal elements of the British Empire ranging from protectorates through colonies to self-governing dominions; but for British arms, it was to be supposed, violence and disorder would have prevailed throughout South Asia and much of Africa (see *EMPIRE, BRITISH*).

In much of the literature on international political economy (IPE), this original meaning has been overlaid with two others, neither of which is consistent with the first. Within *HEGEMONIC STABILITY THEORY*, a comparison is often drawn between a post-1945 *Pax Americana* and a *Pax Britannica* extending roughly from 1850 to 1890, attention being directed in each case to the importance for the existence of a liberal world economy of a hegemon to provide international *PUBLIC GOODS* and to establish regimes (see *HEGEMONY*). The economic character of these public goods (which included encouragement of *FREE TRADE* and provision of a *LENDER OF LAST RESORT*) points to the later nineteenth century, by which time Britain had adopted free trade and a number of major trading countries had adopted the British-based *GOLD STANDARD*. But the scope of their definition is sometimes extended to embrace the role of the British navy throughout the nineteenth century in securing sea routes for the intercontinental trade of all nations. Worse, it is sometimes assumed that British hegemony, whether economic or naval, was responsible for the relative infrequency of war between the European great powers between 1815 and 1914, as when Robert

Gilpin compares 'the century-long *Pax Britannica*' to a much shorter era of US hegemony (Gilpin, 1987: 344; see *HEGEMONY, US*). The first of two problems common to these two usages is that they concern British relations with major trading partners and the continental European great powers respectively, rather than with countries within Britain's formal empire, and while these three sets of countries may overlap they are very far from identical. The second problem is that each definition rests on highly contestable assumptions about economic liberalism – especially regarding its pacific tendency. The implication that Britain was substantially responsible for peace between the European powers in the nineteenth century is an especially egregious error, neglecting as it does the extremely limited expeditionary capability of the British army, already apparent even before it was embarrassingly exposed in the Crimea.

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CHARLES JONES

peace dividend

At the end of wars, governments anticipate a reduction in the defence budget that will free resources for other uses. The fiscal component is often called a 'peace dividend', which can be invested by the government in alternative programmes (a social safety net, education, infrastructure) or can be returned to the people (tax cuts). Peace dividends are most significant economically and politically after long wars like the *COLD WAR* and the Arab–Israeli conflict.

From an economic perspective, wars are consumption binges: workers are removed from the labour force to serve in the military and capital is diverted to the production of weapons that have no long-run productivity-enhancing benefit (except for possible spin-off

innovations – see DUAL-USE TECHNOLOGIES). Peace usually brings difficult economic adjustment (recession), which may be mitigated by the investment of the peace dividend (see also CONVERSION OF ARMS INDUSTRY). Investment of the peace dividend may also improve long-run economic performance. While wartime consumption is included in the GROSS DOMESTIC PRODUCT (GDP) calculus for the current period, causing wars to correlate with economic booms, post-war substitution of investment for consumption contributes to future productivity.

The peace dividend can also have political and strategic value in purchasing support for war-ending treaties, which the populace might otherwise resist. To gain this benefit, governments target the reallocation of resources to key constituencies, such as those most hurt by the end of the war (for example, the arms industry), those most hurt by the terms of the peace (for example, refugees who lost land in a territorial settlement) or those most supportive of the incumbent government (whose political activism might help keep the government in power). However, political investment of the peace dividend may reduce its economic benefit – for example, if the arms industry is compensated with high levels of non-productive peacetime defence procurement.

EUGENE GHOLZ

Pearson Commission

The Pearson Commission, which published the Pearson Report in 1969, was the first in a series of international commissions of eminent persons reporting on international DEVELOPMENT. Later reports have been produced by the Brandt Commission (1980) and the South Commission (1990) (see BRANDT REPORT; SOUTH COMMISSION); the Brundtland report (1987) may be added to this list. Each commission has been headed by a former premier, Lester Pearson having been Canadian prime minister. Southern representation increased over time: the South Commission,

created by the NON-ALIGNED MOVEMENT (NAM) and chaired by Julius Nyerere, comprised only developing-country members.

Each report analysed the global situation and produced recommendations for future development. The Pearson Commission was responding to a perceived crisis in confidence in AID and close to half the report deals with aid-related issues, proposing an aid target of 0.7 per cent of donor GROSS NATIONAL PRODUCT (GNP) (compared to the previous 1 per cent target for all capital flows), a target which has since been adopted by most DEVELOPMENT ASSISTANCE COMMITTEE (DAC) members. More far-reaching recommendations included a call for a free and equitable system of international trade and promoting private foreign investment. These proposals stand in contrast to the agenda for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO), which was emerging around the same time from the meetings of UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD).

The reports are products of their time, but have a common theme of mutual, global responsibility. The former fact is reflected in the concerns addressed: environmental issues are not mentioned in Pearson and only briefly by Brandt, whereas they are central to Brundtland and feature prominently in the South Commission; gender appears only in the most recent of these reports. Some critics point to the failure of these reports to challenge the global system which, they argue, has produced mass poverty; others see the recommendations as either unrealistic or unnecessary.

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HOWARD WHITE

perestroika

Perestroika (or 'reconstruction') was the slogan referring to the programme of political and economic reforms launched under Mikhail Gorbachev after he came to power as General Secretary of the Communist Party of the Soviet Union (CPSU) in March 1985. Internally, *perestroika* was intended to revitalize the stagnating Soviet economy by making it more market-oriented and to introduce limited, but significant, democratic reforms of the political system. Externally, *perestroika* was aimed at restoring the status of the Soviet Union had enjoyed as a superpower in world politics. The Gorbachev regime hoped that these reforms would rejuvenate **SOCIALISM** in the Soviet Union, while maintaining the central role of the CPSU. The reforms helped to end the **COLD WAR**, but fell far short of their objectives, instead leading to further deterioration of the economy, the rise of anti-regime political forces and the further erosion of the CPSU's monopoly of power. The CPSU collapsed in August 1991, followed by the disintegration of the Union of Soviet Socialist Republics (USSR) at the end of the same year.

The Soviet command economy had seriously decayed by the mid-1980s (see **COMMAND ECONOMIES**). According to the (admittedly imprecise) estimates of post-*perestroika* Soviet scholars, the rate of economic growth had been declining since the early 1970s: it had been 3.2 per cent over the 1970–5 period, 1.0 per cent from 1976 to 1980 and 0.6 per cent from 1981 to 1985. Standards of living were no longer improving; the economic gap with the West kept widening, and it became apparent that the Soviet Union was not going to keep pace with the Western third industrial revolution based on information and communication technologies (see **INDUSTRIAL REVOLUTION, THIRD**). The Gorbachev regime attempted to remedy these problems with a series of radical reforms of the overly centralized economy, including reduction of the role and scope of central planning, partial introduction of market prin-

ciples and more non-state ownership in different sectors of the economy.

However, in the face of resistance by recalcitrant party and state officials who struggled on behalf of vested interests in the old system and because of compromises between the radical reformers and the conservatives in the leadership, the *perestroika* reforms ended up as diluted half-measures. Those elements of a market economy that were introduced as part of *perestroika* were mixed with remaining socialist principles to form a confused hybrid economy which performed poorly, as evidenced by shortages of consumer goods, hyperinflation, mounting budget deficits, and declining industrial and agricultural productivity.

Unlike earlier reforms carried out under Khrushchev's programme of 'de-Stalinization' in the mid-1950s to early 1960s, *perestroika* also included far-reaching political changes in the USSR's one-party political system. The Gorbachev regime found that political reforms were necessary to weaken anti-*perestroika* forces, to implement economic reforms and to overcome social apathy. First, political liberalization was carried out. Freedom of the press and of speech were encouraged in the name of *glasnost* ('publicity'), thus offering opportunities to express dissent. State harassment of dissidents was reduced and control over information flows was relaxed. **CIVIL SOCIETY** began to develop rapidly, as the mass media diversified and tens of thousands of informal social associations, political groups and movements emerged. Second, the Gorbachev regime officially initiated the democratization of Soviet politics. Political participation by the Soviet population and political pluralism were promoted. Multi-candidate elections replaced the non-competitive methods typically used in the past in the CPSU apparatus, as well as in the selection of delegates to the newly created USSR Congress of People's Deputies in March 1989. The Gorbachev regime also encouraged the independence of government organizations from those of the CPSU, in contrast with the previous Soviet system in which there was considerable duplication between state and

party structures. At the third Congress in March 1990, the 1977 Soviet Constitution was revised. Article 6 (which stipulated the guiding role of the CPSU in Soviet society) was repealed, paving the way for the emergence of a multi-party system. The presidency was established to consolidate executive power and thus to push further political and economic reforms over the opposition of anti-reform forces. (Gorbachev was elected the first president.) These institutional changes, however, were sufficient neither to fully establish a new political order, nor to bring immediate improvement of economic conditions.

Democratization also had the unintended effect of awakening hitherto dormant nationalisms in the fifteen republics of the USSR. The Russian Soviet Federal Socialist Republic (RSFSR) declared its sovereignty in June 1990 and other republics soon followed suit. This fragmentation of federal power resulted in jurisdictional confusion in the application of laws and implementation of policies, as well as disorder in the economy at the all-Union level. With economic conditions continuing to worsen and with various secessionist movements based on ethnicity or nationality seeking self-determination, Gorbachev increasingly lost control. He was unable to balance the conservative hardliners and the radical democrats, and faced attacks from both sides. Above all, Boris Yeltsin's election as President of the RSFSR by direct popular vote in June 1991 seriously undermined both Gorbachev's base of political support and the influence of the federal centre over the various republics. An aborted coup by the conservatives in August 1991 not only led to the break-up of the CPSU, but also spoiled the scheduled signing of a new Union Treaty which would have delegated more power to the constituent republics. In December, the Commonwealth of Independent States was established by eleven out of the former fifteen Soviet republics. Subsequently, Gorbachev resigned as president and the USSR officially collapsed.

Meanwhile, *perestroika*'s international face was articulated in what Gorbachev termed 'New Thinking'. New Thinking diplomacy was

premised on the assumption that Soviet economic recovery and the eventual closing of the scientific-technological gap with the West required a halt to the arms race with the United States, significant reductions in Soviet military expenditure, and the import of capital and technology from the West. But implementing these far-reaching reforms – domestic as well as foreign – would first require reinterpretation of longstanding Marxist-Leninist doctrine (for example, the inevitability of confrontation between capitalism and socialism – see MARXISM-LENINISM). The viability of the capitalist economic model and claims of its inherently militaristic nature were also reassessed. The New Thinking gave rhetorical emphasis, as expressed in Gorbachev's December 1988 speech to the United Nations (UN), to INTERDEPENDENCE in security (as well as non-security) fields and to the superiority of 'all human interests' over class interests. Likewise, 'reasonable sufficiency' and the 'balance of interests' became the operative principles in strategic arms negotiations with the United States.

These rhetorical changes were accompanied by concrete foreign policy changes that resulted in significant improvements in the country's external relations during *perestroika*. Reconciliation with the United States finally put an end to the Cold War: the Intermediate-Range Nuclear Forces Treaty was signed in December 1987; withdrawal of Soviet troops from Afghanistan was completed by early 1989. The fact that the USSR passively watched as one Eastern European communist regime after another collapsed in 1989, confirmed that the Brezhnev Doctrine had in fact been abandoned. The reunification of Germany was achieved in October 1990. And, while Gorbachev's proposal for building a 'common European home', symbolized the improved state of affairs with the West, the USSR's rapprochement with China also reflected better ties with Asian countries.

In sum, remarkable foreign policy successes were achieved under *perestroika* and, though *perestroika* has not yet brought either economic prosperity or political stability, the

perfect competition

reforms undertaken under this slogan have enabled the former Soviet Union to move far beyond what was possible under the pre-Gorbachev Soviet political and economic systems.

See also:

Stalinism

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SHOICHI ITOH

perfect competition

Perfect competition is a market structure with the following characteristics:

- 1 The product is homogeneous. All firms in the industry sell a product that is identical in the eyes of the consumer, who is perfectly informed about the product and sellers' prices.
- 2 The market contains many sellers who are so small relative to the market that none of them has any influence at all on the market price. Each firm is a price-taker and can sell as much as it chooses at the going price. Since each additional unit of output can be

sold at the going price, marginal revenue equals price.

- 3 Any new firm can freely enter the industry and start producing, while any existing firm is free to cease production and exit the industry. Thus there is freedom of entry and exit, and there are no barriers to entering or leaving the industry.

Markets of agricultural products are often mentioned as examples of perfectly competitive markets. Sugar is sugar and grades of wheat, milk or other farm products adhere to agreed standards. An individual wheat farmer is just one of a very large number of wheat producers who are all growing the same product. Even if an individual farmer doubled or tripled their output of wheat, the effect would be negligible and would not affect the market price. Individual farmers can, therefore, assume that the price at which they sell is independent of the quantity they produce. Finally, anyone who has enough purchasing power to buy or rent land, labour and equipment can become a wheat farmer.

A profit-maximizing firm operating in a perfectly competitive market will produce at a level of output at which marginal cost equals marginal revenue and thus equals price. A distinction should be made, however, between the short run and the long run.

In the short run, price is at least as high as average variable cost. The firm may be breaking even (price equals average total cost, which is the sum of average variable cost and average fixed cost) or making profits (price exceeds average total cost). However, the firm may also be suffering losses (price is less than average total cost). Loss-making firms will leave the industry in the short run, if price is lower than the minimum value of average variable cost. This is the shutdown price. Since price does not even cover average variable cost, larger losses are made by staying in business than by shutting down. If price exceeds average variable cost, but is less than total average cost, part of fixed cost is covered. In this case, smaller losses are made by staying in business than by shutting down.

In the long run, price must cover at least

average total cost. Profits or losses will lead to firms' entry into or exit out of the industry. This pushes any competitive industry to a zero profit in the long run and moves production to the level that minimizes average total cost.

M. PETER VAN DER HOEK

perfect information

Perfect information is one of the conditions that has to be satisfied in order for it to be said that the market is operating under PERFECT COMPETITION. Perfect information implies that each firm and each consumer is fully informed about the available products and their prices.

If a consumer is perfectly informed of the price of the homogeneous product sold by numerous infinitesimally small producers, a uniform price is established. Both producers and consumers behave as price-taking and they cannot influence the prevailing price. If a producer charges a lower price, automatically all suppliers will comply with it, since the perfectly informed consumers will shift their demand to the supplier with the lowest price.

The producer is also perfectly informed about the technique used by the other producers. In no time and at no cost (according to the usual textbook analysis) each producer adopts the most efficient technique for the production of homogeneous products. In the end this process establishes the maximizing conditions of perfect competition at which no excess profit can be sustained in the long run.

There is thus no motivation for producers to apply their own price policy and they merely adopt what the market dictates.

PERSEFONI TSALIKI

PERIPHERALIZATION *see* core-periphery model; dependency theory; world-systems theory

PERIPHERY *see* core-periphery model; dependency theory; world-systems theory

permanent arms economy

The structural instability of capitalist economies, especially their tendency to experience chronic UNDERCONSUMPTION, has been cited by a number of Marxists (see CAPITALISM; MARXISM–LENINISM) as the prime reason for the creation of a permanent arms economy in the United States and, perhaps, other industrial economies. Leading proponents of this approach include Paul Baran and Paul Sweezy (1966), James O'Connor (1973) and Michael Kidron (1968).

While the Marxian approach (see MARXIAN ECONOMICS) incorporating the concept of a permanent arms economy has many variants, a basic theme assumes that the US economy consists of two distinct capital sectors: monopoly and competitive. The monopoly sector is composed of industries dominated by large oligopolies (see OLIGOPOLY) with substantial power and control over their product markets and the economy in general. The competitive sector, on the other hand, consists of those industries containing small, single-product firms with few extra-market resources and minimal economic or political power. Both firms and workers in the monopoly sector are assumed to be more prosperous than their competitive-sector counterparts. Labour in the monopoly sector is also much more heavily unionized, thus magnifying wage differentials between the sectors.

Extending the Marxian argument, this dualistic nature of capitalist production represents the fundamental institutional context within which state fiscal policies are enacted and implemented (see FISCAL POLICY). For example, O'Connor (1973: 23) argues that in the United States the state's ability to finance its expenditure depends disproportionately on revenue from the monopoly sector and on favourable business conditions, which are increasingly affected by patterns of private investment in the monopoly sector. This being the case, if the monopoly sector (and not necessarily the aggregate economy) is economically depressed or stagnating, the state is likely

permanent arms economy

to respond with a fiscal stimulus, often in the form of an enlarged defence budget.

The presumed critical importance of military expenditure in the United States ultimately rests on a particular Marxist view of the state. Unlike the pluralist Keynesian view, which conceives the state as an institution standing above the classes and representing the general interests of society (see KEYNESIAN ECONOMICS), some Marxists argue that state intervention in the economy is necessarily motivated by long-term interests of capital. Military expenditure, unlike most civilian government-spending, is thought (mainly by Marxists) to ensure most effectively the viability of the capitalist order because:

- 1 armaments are quickly consumed or become obsolete, ensuring a never-ceasing demand for weapons;
- 2 powerful ideological rationales exist, centring around the COLD WAR;
- 3 the threat or use of US military power functions to maintain US hegemony (see HEGEMONY, US) in the politics and economics of the capitalist world system, and
- 4 massive social-service expenditures by the state are not a desired alternative, as the expansion of the civilian state sector may compete with private enterprise and profit-making, redistributing income in favour of labour.

What is suggested is that the United States has maintained a permanent arms economy because of the combination of structural constraints impinging on the state budget due to the economic centrality of the monopoly sector and the consolidation of political forces after World War II. According to this line of argument, US economic policy since the war has been controlled by a centre-Keynesian coalition, the members of which include social-spending advocates dedicated to Keynesian-style demand management, Cold War protagonists interested in the containment of the Soviet Union and elite businesspeople committed to the expansion of monopoly capital. A compromise was reached within the centre coalition during the late 1940s, based on

the agreement that when technically and politically feasible, military expenditure – not civilian spending – could best address the goals of big business, organized labour and political strategists. Military Keynesianism (that is, the policy of using the defence budget as a counter-cyclical and economic growth defence – see KEYNESIANISM, MILITARY) was then the chosen mechanism through which economic stabilization and stimulation, and the protection of the capitalist world economy were to be ensured.

In sum, the permanent arms economy that developed in the United States after World War II enables the government to spend massive amounts of public funds without threatening big business. Pressures from the corporate-dominated economy and from organized labour to avert economic stagnation and stimulate the national economy thus play an essential role in determining the size of the defence department's budget.

Outside Marxist circles, the theory of the permanent arms economy, as outlined above, has not been particularly well received. The reasons fall into three general categories. First, the writings of Seymour Melman and others on the permanent war economy suggest that defence expenditure has had a negative effect on economic growth. According to Melman (1974), the militarization of the economy undermines the strength of market economies by encouraging inflationary tensions and reducing the role of efficient units of production. Second, there is considerable empirical evidence (Looney and Mehay, 1990) that, at least in the United States, defence expenditure is largely driven by security considerations, with economic factors playing (if anything) only a tangential role. Finally, the US economic boom of the 1990s (during a period of simultaneously falling defence expenditure) presents a major challenge to the Marxian models.

See also:

military-industrial complex (MIC); national security state

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ROBERT LOONEY

permanent revolution

Although the term 'permanent revolution' was first used by Marx, the theory was developed in the early twentieth century by Leon Trotsky. Based on his account of the dynamics of class forces in Russia, Trotsky argued against the prevailing stagist view that the task of Russian Marxists was to support the bourgeoisie in the development of capitalism. The bourgeoisie was too weak to carry out its 'historic task' and

so the small but powerful working class, in alliance with sections of the peasantry, would have to lead the revolution. The working class would, however, not be content to allow the bourgeoisie to rule as a class and so the revolution would immediately develop a socialist character. It was therefore possible for socialist revolutions to occur first in 'backward' countries, where the productive forces had not developed within a capitalist framework. However, such a revolution only opened up the possibility of socialist development and it was necessary for revolution to spread to advanced nations in order to secure the success of socialism.

Permanent revolution can thus be seen as a strategy derived from Trotsky's acute analysis of the combined and UNEVEN DEVELOPMENT of Russian society. He showed how a small but strong proletariat existed side-by-side with a weak bourgeoisie that was largely dependent on the state. Russian society was very different from earlier capitalist developers and therefore revolutionary strategy should be adjusted accordingly. The stagist approach to HISTORICAL MATERIALISM was rejected, much to the chagrin of the Second International, the MENSHEVIKS and (before 1917) Lenin's BOLSHEVIKS. Ironically, the stagist approach was revived after Lenin's death by the Comintern, under Stalin, which rejected the alleged ultra-leftism of Trotsky's theory.

Despite the brilliance of Trotsky's analysis, there are some problems and unresolved questions. Most importantly, while Trotsky makes a compelling case for socialist revolution in 'backward' nations, it is not clear what happens if such revolutions remain isolated. Although Trotsky suggested alternative economic and political policies for Russia in the 1920s, he still argued at times that the survival of the Russian Revolution depended on its spread to other countries. This position should be seen in the context of international debates within the Comintern and Trotsky's critique of Stalin's disastrous strategies for Communists in (among other countries) China and Germany. But, if Trotsky's argument is taken as a general position (as many of Trotsky's dogmatic

petrochemical industry

disciples do to this day), then one is left with the pessimistic (and apologetic) argument that STALINISM is inevitable if revolution does not spread.

A second problem relates to the question of determinism. Many of Trotsky's current followers argue that permanent revolution remains the basic strategy for revolution to this day. But this is simply ahistorical: a crude unilinear account of historical materialism. Trotsky's strategy, which was derived from a specific account of the *particularities* of Russian society, is elevated to a general principle irrespective of the particularities of other societies. Uneven and combined development therefore become a metaphysical law, rather than a methodology for analysing concrete situations.

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RAY KIELY

PERSIAN GULF WAR *see* Gulf War

petrochemical industry

The petrochemical industry comprises those products derived from natural gas or petroleum. The most famous of these are polymers such as PVC, synthetic fibres such as nylon,

lubricating oils and waxes. In addition, over 80 per cent of all organic chemicals are made from petroleum. The most important sector of the petrochemical industry, however, is the refining of oil.

For much of the twentieth century, the oil industry has been dominated by the 'Seven Sisters': Exxon, Mobil, Chevron, Gulf, Texaco, British Petroleum and Royal Dutch Shell (the first three being successors to the once giant Standard Oil). These companies were largely responsible for propelling the worldwide shift from coal to oil, with their business activities comprising nearly every aspect of the industry from exploration to the retail sales of products at roadside stations. Indeed, during the post-war period the price of oil remained largely stable, stimulating economic recovery and the massive growth of the automobile industry.

In 1960, the major Middle East oil exporters and Venezuela formed the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) to challenge the major oil companies. Increasing dissatisfaction with the 'majors', coupled with Western support for Israel in the YOM KIPPUR WAR of 1973, led OPEC to cut supply, forcing prices to triple. For nearly a decade until oil prices collapsed in the mid-1980s, OPEC became the pivotal actor in world energy markets. Since then, falling profits among the majors resulted in a series of high-profile mega-mergers. In 1998, Exxon announced that it would merge with its rival Mobil to make the largest petrochemical company in the world, soon followed by BP announcing its merger with Amoco and, early in 1999, its intention to buy Atlantic Richfield.

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JASON P. ABBOTT

petrodollars

The term 'petrodollars' came into popular use in the 1970s, when the rapid increase in oil prices created a surge in receipts for oil-exporting nations. Much of the petroleum sold on world markets is priced in US dollars and the dollar-denominated receipts of petroleum-exporting nations are sometimes referred to as petrodollars. Surplus petroleum receipts were invested abroad or lent on international CAPITAL MARKETS, channelling funds back to deficit nations through a process called 'petrodollar recycling'.

The efficient recycling of petrodollar funds from petroleum exporters to importing nations was an important problem. If petrodollars had not been recycled efficiently, many less-developed deficit nations would have been forced to undertake drastic STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) in response to the payments imbalances caused by rising petroleum prices.

Petrodollar recycling took place through private-sector financial markets and helped to strengthen the EURODOLLAR market. The possibility that the United States might seize some foreign bank accounts (or freeze foreign assets) caused some petroleum exporters to prefer EURODOLLAR accounts to normal US bank deposits. Eurodollar deposits had the advantage of dollar denomination without the disadvantages of US financial regulation.

Petrodollar flows in the 1970s had a major impact on the development of the global financial system. Rising oil receipts created a situation in which private-sector lenders needed to place enormous quantities of petrodollar funds at the same time that LESS-DEVELOPED COUNTRY (LDC) deficit nations needed to borrow equally huge amounts. The resulting loans carved new channels for international financial flows which, combined with technological innovations and financial DEREGULATION in the 1980s, created the environment for the formation of a global capital market. Some authors have blamed the SOVEREIGN DEBT crisis of the 1980s in part on bad loans

made in the rush to recycle petrodollar funds in the 1970s.

See also:

debt crisis; Organization of Petroleum Exporting Countries (OPEC)

MICHAEL VESETH

pharmaceutical industry, regulation of the

People need access to pharmaceutical drugs or medicines which are safe, effective, good quality and affordable – and which are accompanied by information allowing individuals to judge a particular medication's merits and risks. Since the early 1970s, public health movements and others have accused the pharmaceutical industry of hindering the development and implementation of policies which aim to further these aims, arguing that the industry puts profits before people's health. The struggle to make pharmaceutical transnational companies (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) more socially accountable still continues.

In the 1960s, many newly independent countries faced the daunting task of transforming national healthcare systems (which had been geared towards meeting the needs of the colonizers) into systems that met the needs of the general population. The prohibitively high costs of pharmaceutical drugs were regarded as a major problem in achieving this transformation. Raw materials were up to 1,000 times more expensive in one country than in another because of overpricing and TRANSFER PRICING. By the mid-1970s, the pharmaceutical companies' unethical marketing practices had joined the list of complaints. The newly appointed Director-General of the WORLD HEALTH ORGANIZATION (WHO), Halfdan Mahler, said in his 1975 report to WHO's member-states:

Drugs not authorized for sale in the country of origin, or withdrawn from the market for

reasons of safety or lack of efficacy, are sometimes exported and marketed in developing countries. Other drugs are promoted and advertised in those countries for indications that are not approved by the regulatory agencies of the countries of origin. Products not meeting the quality requirements of the exporting country ... may be exported to developing countries that are not in a position to carry out quality-control measures. While these practices may conform to legal requirements, they are unethical and detrimental to health.

(WHO, 1975)

WHO thus promoted the idea of *essential drugs*, which it defined in 1975 as:

those considered to be of utmost importance, and hence basic, indispensable, and necessary for the health of the population. They should be available at all times, in the proper dosage forms, to all segments of society.

(op. cit.)

In 1977, WHO published a list of some 200 essential drugs, stressing that:

While drugs *alone* are not sufficient to provide adequate healthcare, they do play an important role in protecting, maintaining and restoring the health of people ... It is clear that for the optimal use of limited financial resources the available drugs must be restricted to those proven to be therapeutically effective, to have acceptable safety and to satisfy the health needs of the population.

(WHO, 1977)

The essential drugs idea was simple: a limited national list of drugs (adequate to meet more than 90 per cent of a country's pharmaceutical requirements) should allow a country to rationalize its drug production, quality control, distribution and provision of accurate information to health professionals and patients. WHO advocated the labelling of drugs by their generic, rather than brand names, on the grounds that increased transparency amid

the bewildering array of different drug names for essentially the same product would allow costs to be cut and would also increase drug safety.

In fact, the essential drugs idea was not new. It was based on attempts by several developing countries to rationalize their national drug policies. WHO's specific contribution was to advocate the concept of essential drugs at the international level: In 1978, WHO and UNICEF launched Primary Health Care as the means of achieving the ambitious goal of Health For All by the year 2000; the provision of essential drugs was one of eight key points in this radical change in health policy. The new approach advocated a move away from curative-oriented increasingly unaffordable high-tech medical systems towards preventive healthcare aimed primarily at serving the needs of the majority of the world's population. In the same year, WHO's member-states requested that the organization develop an international code of pharmaceutical marketing practices to tackle the problem of harmful drug promotion.

The pharmaceutical industry resisted both the attempts to rationalize national drug policies and to subject the industry to international REGULATION. The industry's responses ranged from open threats to WHO and industry critics to more subtle and manipulative strategies. At first, the International Federation of Pharmaceutical Manufacturers (IFPMA), representing the industry associations of forty-seven countries, condemned the essential drugs concept as 'completely unacceptable' (quoted in Kanji *et al.*, 1992: 19). It later accepted the concept, as long as it was restricted to the PUBLIC SECTOR in the poorest countries – implying that the private sector, the so-called 'free market', works perfectly with no need for external intervention.

To oppose any form of international regulation, the industry – together with the US government and the Heritage Foundation (an influential conservative US-based think-tank) – stressed that it was not within the WHO's mandate to become a 'supranational regulatory agency'. As the WHO's efforts to draw up a code of conduct covering the marketing

practices of pharmaceutical companies progressed, IFPMA quickly launched its own voluntary code, arguing that industry self-regulation would avoid wasting precious resources on establishing expensive national and international monitoring systems.

Were it not for the emergence of a new player in the international arena of health policies, the industry might well have had its way. In 1981, however, some fifty consumer, health and development activists from twenty-seven countries formed Health Action International (HAI) as an 'international antibody' to the worst effects of international pharmaceutical practices (Chetley, 1990: 71). This international coalition was modelled on the International Baby Food Action Network (IBFAN), a network instrumental in pressing for the adoption by WHO's governing body, the World Health Assembly, of one of the first UN regulatory codes: the 1981 International Code of Marketing of Breast-Milk Substitutes. In 1982, HAI launched a Draft Proposal for an International Code on Pharmaceuticals, a model regulatory framework covering not only marketing practices but also drug trials and registration, provision of information, RESEARCH AND DEVELOPMENT (R&D) and TECHNOLOGY TRANSFER (Patel, 1983: 317–28).

But the pressure on the WHO not to regulate the pharmaceutical market intensified. The United States backed the industry position, hinting that the WHO should 'not bite the hand that feeds'. Even though the WHO became more and more cautious in its advocacy, the United States still withheld large portions of its contributions (a quarter of the WHO's regular budget) for 1986 and 1987. It was only as a result of the efforts of HAI, concerned countries and consumer activists in demonstrating that the industry's code of marketing was far from effective and through continuing their lobbying, that the WHO adopted Ethical Criteria for Medicinal Drug Promotion in 1988 – but refrained from actively promoting them.

Given these various political constraints, WHO's Action Programme on Essential Drugs and consumer advocates decided in the mid-1980s to focus more on the national imple-

mentation of essential drug policies than on struggling to win acceptance at the international level for the concept of essential drugs and international regulation of the harmful practices of the pharmaceutical industry.

This shift of strategies corresponded to a shift in international politics away from the redistributive NEW INTERNATIONAL ECONOMIC ORDER (NIEO) policies of the 1970s towards the 'free', unrestrained trade policies of the 1980s and 1990s that were promoted by the WORLD BANK and the INTERNATIONAL MONETARY FUND (IMF). This shift in political climate was exemplified by the election in 1988 of a new WHO Director-General, Hiroshi Nakajima, the former R&D director of Hoffmann–La Roche's Japanese subsidiary. Under his aegis, WHO reverted to a more technocratic approach to pharmaceuticals and health.

Nakajima's decade-long era came to an end in 1998, when Gro Harlem Brundtland (the former prime minister of Norway and the chair of the Brundtland Commission on Sustainable Development) was elected as the WHO Director-General. She will undoubtedly have an impact on the way the WHO handles policies which affect the pharmaceutical industry, and other controversial industry sectors such as infant food, tobacco and alcohol.

So too will the gradual realization that not only are many countries in the world far from reaching most of the progressive health-policy targets set in the 1970s, but also the international economic laissez-faire climate of the 1980s and 1990s – usually summarized by the buzzword GLOBALIZATION – has been exploited to the full by TNCs to the detriment of the majority of the world's population – proof that much industry self-regulation is little more than a piece of paper. The future overall direction of international policy-making is anything but clear. The WHO, like many other UN agencies, has begun to advocate 'dialogues' and 'partnerships' with (and sponsorship by) industry as a major development policy approach for the new millennium. Various CIVIL SOCIETY organizations criticize this way of dealing with industry as profoundly undemocratic; others defend it as pragmatic.

philosophical realism

The stage is thus set for further international controversies which will continue as long as people contend that TNCs should be more socially accountable. As the twentieth century turned into the twenty-first century, more than one-third of the world's population did not have access to essential drugs, while advocates of change continue to face resistance from the increasingly concentrated pharmaceutical sector: by 1998, the top twenty companies controlled almost 60 per cent of the world's \$300 billion market for pharmaceutical drugs (SCRIP, 1998: 15).

See also:

international organizations (IOs); Third World; United Nations Conference on Trade and Development (UNCTAD)

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JUDITH RICHTER

philosophical realism

Philosophical realism refers to the view that reality exists independent of our representations of it. Relevant to international political

economy (IPE) in so far as IPE largely prizes empirical testing of its theories, philosophical realism bears a close connection to POSITIVISM. However, the two should not be confused, especially since philosophical realism is intrinsically an ontological, rather than an epistemological, stance. Realism says nothing about our ability to capture truth through intentional representations, but only that there exists an external reality independent of any attempt to measure or otherwise represent it.

A closely related idea is that of the correspondence theory of truth. This theory claims that our linguistic representations directly correspond to external reality. As John Searle points out, correspondence theory and philosophical realism are related in so far as the former implies realism if the linguistic representation is in fact true, but philosophical realism says nothing about whether our linguistic representation is able to correspond to reality. Realism only claims that there is an objective truth to be captured, whether or not we are successful in doing so through any given statement.

Contrasted with realism is idealism, the view that the material world cannot be divorced from our perceptions of it. Contemporary philosophy has expanded on the idealist view in the form of POST-MODERNISM and POST-STRUCTURALISM – these latter trends rejecting the notion that reality can be objectively known and embracing the notion of the multiplicity of truth.

The classical underpinnings of philosophical realism are found in Plato's Allegory of the Cave. Unlike the modern version of philosophical realism described above, Plato's theory posits a reality that may only be partly captured through empirical methods. Known as the 'theory of the forms' or the 'two worlds theory', this account posits a dualistic metaphysics whereby reality consists, on one hand, of a spatio-temporal domain of particular physical objects (the cave) and, on the other hand, of the transcendent realm of universal, eternal, immutable and perfect forms. These two worlds are intimately related in that the physical world of appearance is but a shadow

of the illuminated world of the forms: it possesses no independence and its reality is derivative. The material and particular objects of the sensible world participate in (and imperfectly reflect) the formal and universal nature of the world that is beyond sensory perception.

Because of the dual nature of reality, Plato's theory incorporates both empirical and rationalistic aspects of knowledge (see RATIONALISM). Whereas the material world can be known through our senses, the world of the forms is intelligible only through reason. For example, when we think of numbers or geometrical shapes, we think about their universal properties and not about any particular number or shape that we come into contact with in the world of physical experience. Consequently, for Plato, scientific enquiry alone can never lead to knowledge, since knowledge involves the universal aspects of reality which are only grasped in thought.

Finally, philosophical realism should not be confused with REALISM and NEO-REALISM – these two approaches in international relations (IR) refer to foreign-policy orientations predicated on maximizing power and wealth (with the assumption that politics should be based on a 'realist' view of international interaction, rather than one prizing what 'ideally' should take place between states).

See also:

critical realism; critical theory; philosophical realism

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ALEXANDER AVNI
MIRA SUCHAROV

planned economies

Basic economic problems including what, how much and how to produce commodities must be solved in any economic system. Although there is no general agreement about how to define an economic system, all economic systems are complex and involve the interaction of organizations and individuals, according to rules and orders, in the production, distribution and use of goods and services. Economic systems differ in the way they solve basic economic problems or, in other words, in the way they coordinate economic decisions. Two pure types of economic systems are the market system and the command system (also called the 'centrally planned economy' – see **COMMAND ECONOMIES**). Neither of these systems are real world economies, rather they are theoretical extremes. All real economies contain some elements of each of the two pure systems. Each of them is unique in that they mix elements of the pure systems in different proportions. Real-world economies are called 'mixed systems'. The former Soviet Union was thus a mixed economy, as is the United States.

In planned economies, decision-making is centralized. Some central monolithic authority decides what to produce, how to produce and for whom to produce. A centrally planned economy without the use of **MONEY** is conceivable, but it is difficult to see how the problem of choosing the most economical production techniques is to be solved in a system which does not rest on prices. It is usually assumed, therefore, that command economies will use money to compare heterogeneous input and output, to check on plan-fulfilment, to balance total wages against the total value of consumption goods, and to facilitate the distribution of consumer goods.

A planned economy implies the elaboration of an all-inclusive plan for the behaviour of economic agents. Consumers must abide by the central authority's decisions regarding the quantity and quality of consumer goods, labour must carry out its job wherever needed and managers must meet their production

quotas. In concrete terms, the central authority must decide where each person will live, what clothing individuals will wear, what food they will eat, how many buildings of what type will be built, what materials will be used and so on.

Central planning of an entire economy requires an enormous quantity of data, while the task of analysing this data and producing a fully integrated plan is also enormous. Theoretically, it seems a possible approach. The plan does not need to be made all at once and forever, and the central planning authority can start from the existing situation and decide in which direction to change the allocation of resources. In practice, however, it is an impossible task to run an economy entirely by command and in full detail. Even with the best and largest computers it would not be possible.

The former Soviet Union was the first country to organize its economy on the basis of central planning. Immediately after the October Revolution of 1917, banks and factories were nationalized and (in 1928) the first comprehensive economic plan was introduced. It envisaged a shift in the share of private consumption towards investment and military expenditure, and the collectivization of agriculture. The economic success in the early stages of industrialization suggested that the planning mechanism was as good a coordinating principle as the market mechanism. In 1957, the Soviet Union launched the first satellite, which raised even more interest in the planning mechanism. However, the collectivization of agriculture had been a disaster from the outset and agricultural productivity has always been relatively low compared to Western levels.

Although the former Soviet Union and the socialist countries of Central and Eastern Europe used prices, they were inflexible and not even theoretically related to relative utilities or scarcities. This reflects the main problem of planned economies: prices have no guiding function. In a market system, the price mechanism coordinates the decentralized decisions made by numerous economic agents. Although the price mechanism is not perfect

– MARKET FAILURE is a well-known phenomenon in market economies – in general it works better and more efficiently than central planning. The market mechanism works as an INVISIBLE HAND coordinating numerous decisions that are independently taken by numerous producers and consumers. Market prices tend to clear markets, avoiding shortages of some goods and surpluses of others. In the 1980s and 1990s, it became clear that no planning mechanism is able to coordinate millions of interconnected decisions so well as the market principle.

Obviously, the allocation of the material resources and of labour is too complicated a task. Central planners can monitor the number of units produced by any factory, rewarding plants that exceed their production targets and punishing ones that fall short. Factory managers may meet their quotas, but what happens to the goods once passed out of their factory is not their concern. In market economies, prices are used to signal customer satisfaction and dissatisfaction. Poor quality will lead to low sales and retailers will shift their purchases to other producers, which serves as a signal to factory managers. This feedback mechanism is absent in a planned economy.

In the former Soviet Union and the other socialist countries of Central and Eastern Europe, workers usually had complete job security. Unemployment did not exist; being unemployed was actually considered a crime. Labour-hoarding by companies was a normal phenomenon. Under these circumstances, there were insufficient incentives for reasonably hard and efficient work. Income differentials did not provide the incentives that are usual in market systems; rather, they took the form of privileges to members of the Communist Party, including access to special hospitals, special resorts and particular special stores that not only avoided queuing and waiting, but also provided imported goods that were not available in regular stores.

The problems that the former Soviet Union and the other countries of Central and Eastern Europe faced after the upheavals of the late 1980s and early 1990s show that markets

cannot be installed overnight. The transition from a planned economy to a market system has proved to be difficult and painful. In the first years after the upheavals, output fell sharply and unemployment rose. Inflation was high and living standards dropped. However, the fall in WELFARE was probably much less than the drop in output. This is the result of the misallocation of resources in the planned economies. A lower production of weapons and barbed wire does not necessarily imply a lower living standard. The planned economies heavily emphasized the MILITARY-INDUSTRIAL COMPLEX (MIC). They gave a high priority to the production of machinery and military goods, and skimmed on the production of consumer goods. This was an allocation of resources, which did not reflect the preferences of individuals and households.

A successful transition from a planned economy to a market system requires severe changes in the behaviour of economic agents, who have to learn to respond to market signals. In addition, a new economic, social and legal infrastructure has to be developed. A market system requires a clear system of PROPERTY RIGHTS and an extensive civil law system that facilitate the enforcement of contracts. Establishing the necessary institutions, enacting the necessary laws and, in particular, the change of behaviour patterns is a time-consuming process. In addition, the conversion of the production of military and industrial goods to consumer goods (see CONVERSION OF ARMS INDUSTRY) is a difficult process. Not only machines and production processes have to be changed profoundly, but also management and workers have to be retrained. In many cases, conversion is simply impossible. How, for example, is a missile factory to be converted into a producer of consumer electronics? Despite all these problems, the transition recession has bottomed-out in most of the former planned economies in Central and Eastern Europe. Inflation has more or less stabilized and output is growing again. However, the former planned economies still have a long way to go.

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M. PETER VAN DER HOEK

plantation economy

The theory of plantation economy was conceived within the so-called 'New World Group' of radical economists working within the University of the West Indies in the 1960s and early 1970s, and constitutes the most sophisticated Caribbean variant of DEPENDENCY THEORY. Devised initially by the Trinidadian Lloyd Best in collaboration with the

Canadian economist Kari Levitt, it consists of a historical and structural analysis of the development of plantation economy in the Caribbean from the seventeenth century to the modern post-independence period. Best and Levitt emphasized that their primary interest lay in 'isolating the institutional structures and constraints which the contemporary economy has inherited from the plantation legacy', but suggested that the different stages in the evolution of the Caribbean economy should be seen as 'successive layers of inherited structures and mechanisms which condition the possibilities of transformation of the present economy' (Best and Levitt, 1969: n.p.).

The first phase, which covered the period from about 1600 to the abolition of slavery in 1832, was classified as 'Pure Plantation Economy' and was crucial in setting the framework for the development of the Caribbean as an 'overseas' economy of a distant industrial metropole. 'Plantation Economy Modified', which spanned the hundred years from 1838 to the eve of World War II, saw only adjustment, not economic transformation. Most importantly, post-1945 development policies – for all their successful embrace of IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI), mineral exports and tourism – were considered only to have effected 'Plantation Economy Further Modified'. The basic integration of the plantation economy into the economic system of the metropole was seen to have been replicated by the TRANSNATIONAL CORPORATIONS (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) that had come to dominate the new growth sectors.

Other New World economists built on Best and Levitt's pioneering work and the school was able to mount a powerful critique of what it derisively dubbed the 'industrialization by invitation' strategy of most post-independence Caribbean governments. This laid the basis for the radical politics essayed in parts of the region in the 1970s. However, plantation economy theory was ultimately inhibited by an over-economistic and excessively mechanistic approach, which blinded it to the changing political interests which sustained the inherited

economic structures of the region. This intellectual weakness also undermined the practical attempts made to address the problems identified by the theory.

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ANTHONY PAYNE

Plaza Accord

The Plaza Accord was agreed on 22 September 1985 by the GROUP OF 5 (G-5) countries to coordinate intervention in FOREIGN EXCHANGE markets to push the dollar down from the heights it reached in the early 1980s, as internationally mobile capital flooded into the United States to take advantage of 'REAGANOMICS'. The rising dollar was blamed for the growing US trade deficit, particularly with Japan. Consistent with its free-market ideology, the Reagan administration had rejected earlier foreign calls for coordinated intervention to push the dollar down, but complaints from US industry hurt by the high dollar and growing protectionist pressures in Congress encouraged

newly appointed officials of the second Reagan administration to join with foreign governments in calling for the appreciation of non-dollar currencies and in intervening in foreign exchange markets to promote currency realignment. Most analysts believe that the Plaza Accord did help to push the dollar down, thereby demonstrating the effectiveness of policy coordination in the Group of 7 (G-7), even in the face of capital mobility; some claim, however, that the dollar's subsequent drastic decline merely continued a market-driven trend that had been apparent earlier.

See also:

Group of 7 (G-7); Group of 7 (G-7), policy coordination in the

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MICHAEL C. WEBB

pluralism, economic

The notion of 'economic pluralism' points to the necessity of combining diverse functional elements, like tradition, market and central-planning modes of allocation and distribution, in order to secure the reproduction of an economic system. Economic pluralism is designed to counter the idea that pure market systems are preferable, as most AUSTRIAN SCHOOL economists emphasized; the orthodox

Polanyi, Karl

Marxist project of establishing a comprehensive planning system without market elements (see MARXISM–LENINISM) is also rejected.

It is assumed that economic systems do not follow, either in theory or in practice, a unitary logic of market CAPITALISM versus socialist PLANNED ECONOMIES. Most markets exhibit an incomplete structure and are therefore subject to MARKET FAILURE. Moreover, markets are a type of institution, thus they cannot be strictly separated from the sphere of public intervention and regulation. This does not imply that planning systems are more efficient, for they suffer from coordination problems due to the dispersion of information and knowledge.

Economic pluralism underlines the structural and institutional variety that marks the historical evolution of economic systems. This corresponds with a distinct policy position that is mirrored by the debates on MARKET SOCIALISM and decentralized planning.

See also:

command economies; market socialism; markets as institutions; state socialism

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ALEXANDER EBNER

Polanyi, Karl (1886–1964)

Karl Polanyi was born in Vienna of middle-class Jewish parents. He was raised in Budapest and he entered the university there to study law. He read widely in the social sciences and was influenced in particular by Aristotle and socialist writers, such as ROBERT OWEN and KARL MARX. A violent political debate led to

his expulsion from Budapest and forced him to finish his degree at the University of Kolozsvár.

His short career as a practising lawyer was interrupted by World War I. Serving in the Austro-Hungarian army, he was badly wounded in 1917 and returned to Budapest. For a few years he worked as a journalist. With the rise of Nazism, he fled to England and lectured for the Workers' Educational Association. After a lecture tour in the United States, he received a Rockefeller Foundation Fellowship and wrote the bulk of his classic work *The Great Transformation* in 1941–3. The book was completed in England. In 1947, Polanyi took up a post as a Professor of Economics at Columbia University, New York. It was in the United States that he began to identify himself as an institutional economist (see INSTITUTIONALISM).

Polanyi's work challenges both the subjectivist and the utilitarian foundations of economic orthodoxy. Like ADAM SMITH, DAVID RICARDO and KARL MARX, Polanyi took the distinction from Aristotle that use-value had an objective quality relating to the usefulness of an item for humankind. The pursuit of use-value was direct and overt in traditional institutions such as the household, but obscured by the quest for exchange-value in the market.

Polanyi argued that Adam Smith's dictum that people had a natural propensity 'to truck, barter and exchange' was unsupported by modern evidence from anthropology, particularly studies by Thurnwald and Malinowski of primitive communities. In such contexts, the desire to make profits from production and exchange was absent. Instead of contract, there was reciprocal gift-giving. In particular, labour was performed not in return for contracted payment but as a duty or gift.

Although they have a long history, exchange, markets and money have been peripheral to most economies prior to the modern era. Polanyi argued that economic relations are always embedded in complex social relations, without which the market economy cannot function. Markets are built upon, and are not prior to, other social relations. They are always

dependent on, and embedded within, the institutions, relations and culture of social life. It is only in modern capitalist society that market and exchange relations between rational, calculating agents have appeared autonomous or disembedded. But by undermining this unacknowledged institutional and cultural support, 'free' markets have placed modern civilization in a profound crisis.

Polanyi identified principles of behaviour, which seem to have universality across all forms of economic and social organization. One is called *reciprocity*, defined as obligatory and reciprocal gift-giving between persons who stand in some specific social relationship with each other; another, *redistribution*, involves obligatory transfers to some central and encompassing authority. Although generally present, these basic integrative mechanisms can take different forms in different socio-economic systems.

For instance, reciprocity may take the form of regular and ritualized two-way transfers of gifts. To the modern mind, such behaviour may appear as simply underdeveloped barter or trade. However, even in a capitalist society, reciprocity takes a variety of forms – such as within the household – which obtain their particular meaning precisely because they are not reducible to commodity exchange and are disregarded by any overt calculus of gain or loss.

The concept of redistribution can be understood in its modern manifestation of taxation for the provision of defence and other state services. However, it has a much more general meaning and can take many forms (such as tributes, tithe or labour services). Redistribution serves not only to provision central services, but also to emphasize the boundaries and unity of a group and the authority/legitimacy of its leaders and central institutions.

While markets in some form have existed for thousands of years, only in modern society do they dominate and largely regulate the economy as a whole. Under classical antiquity and FEUDALISM, markets were defined and set apart as places where people met and exchanged

goods. By contrast, in modern society the market is associated with a complex and widespread mechanism of supply and demand, leading to the formation and adjustment of prices, and assuming important self-regulating functions for the system as a whole. More particularly, the market is associated with a whole social culture and shared set of meanings: of individual private property and the deliberate pursuit of individual gain.

Polanyi emphasized that the market itself is not a natural phenomenon. It does not reflect the fundamentals of human nature. It is also wrong to see the modern market as heralded by the trade and markets of the past. Against this, Polanyi argues that the modern market is the result of the contingent combination of varied and independent cultural and ideological elements, stemming from diverse changing institutional backgrounds.

Furthermore, the modern market system did not emerge spontaneously from the interaction of autonomous individuals. In many respects, it is the result of political action and even conscious design. However, Polanyi did not make the error of assuming that all social institutions are designed or planned. He admitted, like Marx and others, that unintended consequences were important in social life. Concerning the modern market, however, his key point is that it required extensive political intervention and legislation. As he put it in *The Great Transformation*:

There was nothing natural about *laissez-faire*; free markets could never have come into being merely by allowing things to take their course ... *laissez-faire* itself was enforced by the state ... To the typical utilitarian ... *laissez-faire* was not a method to achieve a thing, it was the thing to be achieved.

(Polanyi, 1944: 139–41)

This conception of the market, as something contingent rather than natural, differs from the treatment of the market in orthodox economic theory. In economics textbooks, the market is presumed to be the spontaneous result of individual interaction, magically appearing

whenever goods or services are transferred from one agent to another. In contrast, for Polanyi, the market is a *historically specific social institution*, created like other institutions in part through conscious design.

Not only was the state necessary to establish LAISSEZ-FAIRE once a relatively 'free' market system had been established, as in Britain in the first half of the nineteenth century, the very operation of the supposedly 'self-regulating' system required continuous meddling and monitoring by the state: 'The road to the free market was opened and kept open by an enormous increase in continuous, centrally organised and controlled interventionism' (ibid.: 76). Polanyi described this as a 'double movement':

While on the one hand markets spread all over the face of the globe and the amount of goods involved grew to unbelievable proportions, on the other hand a network of measures and policies was integrated into powerful institutions designed to check the action of the market relative to labour, land and money ... Society protected itself against the perils inherent in a self-regulating market system – this was the one comprehensive feature in the history of the age.

(op. cit.)

This is a powerful rebuttal of neo-liberal protestations against state intervention.

In which other respects is Polanyi's work relevant today?

- 1 At a fundamental theoretical level, Polanyi's economic anthropology rehabilitates Aristotle's non-subjectivist concept of use-value, which had been taken up by Smith, Ricardo and Marx. His work provides an alternative to the utilitarianism and subjectivism that has dominated economics for more than a hundred years. It points to the study and evaluation of real human needs as an alternative to the unquestioning acceptance of the sovereignty of individual wants.
- 2 Polanyi's argument that the creation and maintenance of the 'free' market necessitated continuous and extensive state intervention

has clear application to attempts to widen the scope of the market in modern economies. Neo-liberal proponents of these policies wrongly assume that they involve 'rolling back the state'. Polanyi's analysis shows that any such movement is not likely to lead to the announced diminution of state powers, but instead to increasing intrusion and regulation by the central state. This has been borne out acutely in the United Kingdom in the 1980s.

- 3 Polanyi's analysis serves as a warning: attempts to give the market unrestrained powers are likely to be disruptive and dislocative, rather than leading to social harmony. Instead of the spontaneous social order imagined by neo-liberal advocates of the unregulated market, the consequence can be social destruction, leading even to war.
- 4 In the case of the creation in the 1990s of a single market in the European Union (EU), Polanyi's argument counters the neo-liberal belief that such an integrated market is possible without corresponding federation or integration at the political level, and the establishment of a European state apparatus. Extended and integrated markets require a corresponding extension of the supervisory and regulatory apparatus, at a minimum to establish standards and to ensure compliance with contracts. For Polanyi, furthermore, extended markets depend on the symbolic and practical support of a unified currency and integrated banking system. Finally, in a democratic system subject to sustained pressure from trade unions and enlightened employers, the extension of market is likely, in response, to stimulate general EU measures to protect working conditions and to safeguard employees.
- 5 Although Polanyi wrote at a time when central planning and socialism were popular ideas among Western intellectuals, his ideas are still of profound significance in the post-1989 period. As noted above, he stressed the unavoidable connections between markets and social relations/institutions. The pursuit of a pure and entirely free market system is

thus an unobtainable dream. Polanyi's work suggests that the market cannot be sustained without both state regulation and a particular type of developed and ingrained social culture. Without the full development of such a culture, attempts to expand the market in the East will bring severe problems and by no means act as the panacea anticipated by some economists.

This last point is amply confirmed by experience in the former Eastern Bloc countries. When 'market shock therapy' was imposed after 1989 by Western advisors, the universal result was a severe contraction in industry, agriculture and employment. The market did not emerge spontaneously once the former state controls were removed. This was because the cultural and institutional preconditions of the market were underdeveloped. Subsequently, some of these countries adjusted their policies in the early 1990s and a patchy recovery began. The more successful – such as the Czech Republic and Poland – were able to build on a relatively developed CIVIL SOCIETY and integrated social culture, and a stronger and less remote history of capitalist market relations in the past. By contrast, Russia, with a weaker and more remote history of market relations, and without the same degree of social integration, still lacked the institutional and cultural preconditions of capitalist markets. It took longer to emerge from economic chaos.

For these and other reasons, Polanyi's work retains its force and relevance today. Notably, Karl had a brother who also achieved world fame. After a career as a chemist, Michael Polanyi made a set of noted contributions to philosophy. Although differing in their political views, both brothers have had a major positive influence on twentieth-century thought.

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GEOFFREY M. HODGSON

polarity

Polarity is central to the concerns of INTERNATIONAL POLITICAL ECONOMY (IPE) because it is a causal factor that accounts potentially for variations in countries' economic exchanges. Most political economists implicitly accept as an axiom the proposition that changes in the international distribution of POWER between states influence the economic transactions that cross national borders. Despite polarity's salience, the concept's intellectual origins are obscure and the construct frequently is used inconsistently to define different dimensions of the degree to which power is concentrated or dispersed among the sovereign members of the INTERSTATE SYSTEM.

In its most generic sense, 'polarity' is a metaphor that derives from the semantic meaning of a 'pole' as any force at the end of a hypothetical axis that, like a magnet, attracts or repels objects. Polarity is attractive in the study of global conditions as a metaphor for capturing the propensity in most economically

polarity

and politically interdependent systems (see INTERDEPENDENCE) for hierarchial divisions to develop in status and wealth, and for the stratification to generate political realignments as well as EXPLOITATION. Polarity is a variable at the systemic level of analysis that emerges when members of the international system concentrate in a particular alignment around one or more power centres, with states pulled into clusters (see LEVELS OF ANALYSIS). When polarity is exhibited, economic, political and/or military power is divided internationally, as in the formation of TRADE BLOCS.

Unfortunately, despite its salience for GEO-ECONOMICS, GEOPOLITICS and geostrategic relations, polarity is an ambiguous concept that lends itself to multiple meanings and applications. There exists little consensus about the operational definitions by which the concept is validly measured. A multidimensional concept indexed by multiple empirical indicators, polarity nonetheless is widely used to describe alternative global power distributions, and to explain and predict the interactions of individual states.

To illustrate the differential ways in which polarity enters theoretical discourse, note first its prominence in analyses of world politics informed by political REALISM. Realist theory embraces a BILLIARD BALL MODEL that treats polarity as a key attribute of the shifting balance of power influencing patterns of relations between states. To proponents of STRUCTURAL REALISM, transformations in the distribution of military capabilities from one polarity structure to another are influential causes of the periodic outbreaks of great-power wars, when 'power transitions' in the globe's HEGEMONIC CYCLE unfold. In the *realist* construction, polarity refers primarily to the changing distribution of *military* power and envisions several potential polarity distributions – with unipolar systems having one dominant power centre, bipolar systems containing two power poles and multipolar systems possessing three or more such poles.

Second, note how polarity is used in IPE and WORLD-SYSTEMS THEORY to examine how changes in the global *economic* distribution of

power modify such conditions as levels of and rules for international trade, IMPERIAL RIVALRY and the practice of IMPERIALISM. The assumption guiding theorizing here is that the global concentration or dispersion of financial resources heavily shape such variables as international economic and monetary relations, LONG CYCLES of economic growth, and individual countries' share of the global market. For example, polarity is associated with the formation of trade blocs and FREE TRADE AREAS (FTAs) that account for redirections of the flow of FOREIGN DIRECT INVESTMENT (FDI), foreign aid and BALANCE OF PAYMENTS transfers. Polarity is also associated with HEGEMONIC STABILITY THEORY, which posits that when a single state is much more economically influential than any of its rivals, such a concentration of economic resources in a predominant pole or centre of economic power enables the hegemon to provide the system with COLLECTIVE GOODS, and to manage a stable international political economy of FREE TRADE that is consistent with tenets of LIBERALISM.

At the centre of analyses of polarity are three major controversies. Beyond the issue of the most valid ways of measuring international polarity structures, the first extensively researched but unresolved question concerns the specific conditions that cause different polar systems to degenerate into war or economic collapse, as well as those conditions under which they tend to remain peaceful and prosperous. Second, despite decades of replication studies, research has not culminated in agreement about the relative impact of unipolar, bipolar or multipolar distributions on the level of international military security and economic stability. The third research controversy centres on the challenge of how to treat as an endogenous variable the process of *polarization* – that is, the propensity of countries to cluster around a powerful pole through alliance- or coalition-formation, when a system with multiple power centres breaks into two countervailing blocs whose interactions exhibit increasing levels of conflict, while the interactions within each bloc become more

cooperative. Whether polarization is beneficial remains a matter of debate, because the consequences have not proven consistent across period and place.

Polarity is likely to remain a principal construct in the conceptual baggage carried by students of international relations and IPE, despite the concept's limitations and ambiguity. Because the distribution of economic, military and political power is so fundamental as both independent and dependent variables, evaluations of global polarity configurations appear destined to command a continuing place of prominence in scholarly analyses and policy discourse.

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CHARLES W. KEGLEY, JR

political business cycle

The 'political business cycle' is a model of governmental and electoral behaviour which links policy directions to a reward/punishment model of voter decision-making. The model has two main components. The first relates to government behaviour: it assumes that (1) governments wish to be re-elected and (2) they can successfully manipulate the economy, from which it is deduced that (3) governments manipulate the economy for potential electoral gain. The second component of the model relates to voter behaviour: it assumes that (1) voters seek economic benefits and (2) they reward governments which deliver benefits but punish those that fail to deliver. As a consequence, governments campaign at elections on their economic records and those that are perceived by the electorate to have been successful are re-elected.

A large volume of empirical research has been undertaken in Western democracies designed to test this model and has raised a variety of issues. First, for example, do voters make their decisions retrospectively or prospectively? Do they base their voting decisions on candidates' past records of economic success or on the prospects of them delivering what they promise if elected? Second, do people evaluate a party's performance and promise on the basis of (1) their personal/household financial situations (so-called 'ego-centric voting'), (2) the condition of the national economy ('socio-tropic voting') or (3) the condition of their local economy – or on the basis of some complex weighting of all three? Third, what are the economic indicators that people take most account of when evaluating government performance: unemployment levels, taxation levels, mortgage

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interest rates, inflation rates, growth rates of GROSS DOMESTIC PRODUCT (GDP) and so on? Finally, does this mean that there are clear cycles of economic indicators linked to the electoral timetable (for example, low inflation, unemployment and interest rates with high rates of growth of personal prosperity in the months preceding an election, but deteriorating conditions thereafter) or are voters continually evaluating government performance (and their opponents' promises) so that short-term trends in the run-up to an election may not be crucial to their decisions?

Irrespective of whether governments can manipulate economic variables sufficiently to influence the 'feel-good factor' in the period before an election, there is a widespread belief that this is a very important influence on the voting decisions of increasingly large proportions of the electorate. Certainly some models have very successfully predicted election results on the basis of a small number of economic variables. David Sanders (1994), for example, successfully predicted the outcome of the 1992 general election in the United Kingdom using just two basic variables: the rate of growth of GDP and the 'feel-good factor' – optimistic people rewarded the incumbent government while pessimists voted to punish it. But other factors may come into play: in the 1980s, for example, many British voters who were pessimistic failed to punish the government because they thought the alternative would be even worse and, in 1997, many who were 'feeling good' nevertheless voted against the government because they doubted its long-term competence in economic management (based especially on experiences in late 1992).

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RON JOHNSTON

political culture

'Political culture' has been defined as the study of a people's orientations to politics (Hague, Harrop and Breslin, 1992: 135) or a shorthand expression to denote the emotional and attitudinal environment within which the political system operates (Kavanagh, 1972: 10).

Political culture is a concept which became popular during the 'behavioural revolution' of the late 1950s and 1960s when political scientists were seeking a potentially unifying concept for the discipline of political science and began to switch their attention away from the analysis of formal political institutions towards the analysis of informal behaviour. However, political culture is not primarily concerned with actual political behaviour but rather with what people think about politics – that is, their values, attitudes and beliefs, and (more specifically) their attitudes, values and beliefs about government. In this regard, the seminal study of political culture in a liberal democracy, Gabriel Almond and Sidney Verba's *The Civic Culture* (1963), suggested that a process of adult political socialization was critical to the development of the attitudes which would subsequently shape people's political behaviour (Almond, 1988: 29).

Political scientists have often referred to the national political culture of a particular society, but part of the problem with such sweeping generalizations is that they have overlooked the fact that the political culture of a nation forms only one part of the broader culture of that society. There are also likely to be many competing political cultures within a society. Indeed, the diversity of political cultures within a society may sometimes be greater than the differences between it and the national culture of other countries. Furthermore, it is particularly important to distinguish between the political culture of governing elites and those

of the governed, especially in less-developed societies where the political attitudes of local populations may be more heavily influenced by local elites.

Part of the difficulty in studying political culture lies in its dynamic quality. The political attitudes and values of groups and individuals within society are constantly changing. At the same time, culture is a collective phenomenon, but political scientists have to gather data at the level of the individual or from some subset of society. This has raised the problem of how to weigh the importance of the attitudes of one group or individual against those of another. Political culture clearly transcends the individual, but not to the extent that the individual's actions are entirely negated. Therefore, a careful balance has to be struck between the micro-level of the individual's beliefs and the macro-level of the broader political culture.

The concept of political culture has been criticized for being tautological, for being unable to account for social change and for ignoring power relations. However, the principal criticism levelled against it has concerned the implication that political culture causes institutional structures. Critics have contended that culture is a consequence and not (or at least not only) a cause of institutional structures (Thompson, Ellis and Wildavsky, 1992: 507–8). Despite these criticisms, the importance of political culture has been illustrated by the collapse of communism, which demonstrated that even totalitarian regimes could not survive indefinitely in the absence of popular legitimacy.

See also:

culture, economic role of

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SIMON LEE

political economy

The fact, as JOSEPH SCHUMPETER once famously noted, that political economy has 'meant different things to different writers, and in some cases it meant what is now known as economic theory or "pure" economics' (Schumpeter, 1954: 21) is indicative that there is no single approach or school of thought within the discipline. Political economy is instead characterized by a large number of contending schools of thought, each of which is distinguished by its distinctive understanding and portrayal of the relationship between politics and economics. Political economy does not reject economic theory, but instead recognizes that there are limitations to any form of social scientific inquiry that displays a tendency towards economism, ahistoricism or apoliticism. Thus, although political economy is built largely on the insights of politics and economics, it also draws on history, sociology and anthropology to provide an understanding of the socio-cultural and historical context in which politics and economics are played out. Political economy therefore tends towards an interdisciplinary, multidisciplinary and comparative approach to the relationship between the state and the market.

Although the history of political economy has been punctuated by the development of different schools that have debated the theoretical, ideological and methodological dimensions of their discipline, there nonetheless has

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been a consensus that the principal concern of political economy is the relationship between the public and private spheres. The public sphere has been understood as the arena of politics, in which the dominant institution has been defined as the nation-state; the private sphere has been understood as the arena of economics, in which the dominant institution has been defined as the national market (Gamble *et al.*, 1996: 5). More recently, further important distinctions have been drawn between domestic political economy and the realms of political and economic activity above (regional, international, supranational, global) and below (local, regional, federal) the level of national government, and between the development of the industrialized North and the developing (often underdeveloped) South.

Political economy is neither an objective, value-free science, nor a detached, ivory tower, purely academic debate about the relationship between states and markets. On the contrary, it is an inherently normative and practical discipline which

consists of prescription rather than description; although, since it is concerned with practice, its recommendations make use of what aspires to be a scientific examination of the results of action rather than wishful thinking regardless of consequences.

(Robbins, 1976: 3)

In short, political economy 'is essentially a search for solutions to problems of policy' (op. cit.). It provides

an exposition of a comprehensive set of economic policies that its author advocates on the strength of certain unifying (normative) principles such as the principles of economic LIBERALISM, of SOCIALISM, and so on.

(Schumpeter, 1954: 38)

The term 'political economy' was first used in France in the early seventeenth century. Until that juncture, economy or economics (derived from the Greek *oikonomike*) had traditionally referred to household management because it had been primarily within the household and the family that wants and needs

had been satisfied (Groenewegen, 1994: 905). However, with the growth of trade and commerce during the seventeenth century, new and important schools of economic thought began to emerge in Western Europe which attempted to understand the operation of the economy not of the single household but of the entire nation-state. In particular, MERCANTILISM (the theory and exercise of national economic power) and physiocracy (the belief that only agriculture could generate an economic surplus because of its ability to harness the productive powers of the land – as opposed to manufacturing's mere transformation of existing products) gave impetus to the development of a new science of economic organization. Monarchs and statesmen preoccupied with nation-building began to become more concerned with the nature, reproduction and distribution of the wealth of nations and how the affairs of the state should be effectively managed so that the wants of the population could be addressed.

In his seminal enquiry into the nature and causes of the wealth of nations, ADAM SMITH defined political economy as 'a branch of the science of a statesman or legislator' whose twin and distinct objectives were 'first, to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly, to supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign' (Smith, 1964 [1776]: 375). As a consequence, political economy became the term that was used to refer to the management of the affairs of the state, as opposed to the economics of the household (Caporaso and Levine, 1992: 1). Indeed, the ensuing debate about the appropriate role for the state in the development of the market economy has remained the central debate within the discipline of political economy ever since.

Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* gave birth to the age of classical political economy which lasted until the publication of *Principles of Political Economy* by JOHN STUART MILL in

1848, and whose other principal authors included DAVID RICARDO and THOMAS MALTHUS. The principal tenets of classical political economy were (1) the capacity of markets to regulate themselves through the INVISIBLE HAND of the market, (2) the separability of the economy from politics, (3) the assertion that the economy need not be political and the rise of CAPITALISM would depoliticize the economy, (4) the primacy of the economic sphere and (5) the manifestation of the economic in the institutional reality of the market and the political in the institutional reality of the state (*ibid.*: 3).

During the latter decades of the nineteenth century, the term 'political economy' was gradually displaced and eventually replaced by 'economics' as the conceptual shorthand for the study of the process of economic development. At the end of the nineteenth century, the emergence of the neo-classical school saw the retention of the classical school's separation of politics and economics, but the additional application of the theory of utilitarianism to the study of the nature and purpose of the market economy. Thus, for neo-classical political economy,

'economics' refers to private transactions in pursuit of utility maximization, 'politics' to the use of public authority in the same cause. (*ibid.*: 4)

Political intervention has been held to be necessary where the market has failed to maximize individual satisfaction.

During the first half of the twentieth century, neo-classical political economy continued to use political economy as a synonym for economics until a revolution in the theory and practice of political economy was set in motion by the work of JOHN MAYNARD KEYNES (Groenewegen, 1994: 904). Keynes criticized both the classical and the neo-classical schools for their assumption that, left to their own devices, self-regulating markets would necessarily deliver a condition of full employment. His contention was that this was only one of a number of scenarios for investment and output, included in which was the possi-

bility that the economy might perform with a significant underutilization of the available resources, resulting in mass unemployment. Therefore Keynes advocated the use of the state's finances to ensure that the level of effective demand in the economy would be sufficient to sustain a high level of employment.

Keynes redefined political economy by providing a much broader definition of the notion of MARKET FAILURE, challenging the classical separation of politics and economics, and inspiring a repoliticization of the market and its management. Largely as a consequence of Keynes' writing (and the development of a school of KEYNESIAN ECONOMICS from Keynes' work after his death in 1946), political economy enjoyed something of a post-war renaissance. However, the true resurgence of political economy in the early 1970s, and its transformation into INTERNATIONAL POLITICAL ECONOMY (IPE), ironically coincided with an attack on Keynesian ideas and economics at both the international and the national levels.

At the international level, the partial collapse (leading to the onset of financial DEREGULATION and LIBERALIZATION) of the post-war Bretton Woods international economic order of FIXED EXCHANGE RATES (see BRETTON WOODS SYSTEM), of which Keynes had himself been one of the principal authors (along with Harry Dexter White), the Arab-Israeli oil crisis of 1973-4 (fuelling inflation and rising unemployment in the industrialized North, and irresponsible bank lending to and eventual crippling debt in the underdeveloped South) and the demands for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) from developing economies (exposing increasing tensions between the agenda of the impoverished South and the affluent North), combined to inspire a new generation of scholars, particularly those from an international relations (IR) background. Their work was the product of an increasing sense of dissatisfaction with the limitations of pure economic theory and its inability to provide effective solutions to growing economic and social problems (notably structural unemployment, poverty and environmental degradation),

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and of the rapid growth in the power of non-state actors, especially MULTINATIONAL CORPORATIONS (MNCs).

At the national level, the deteriorating external prospects for world trade and growth helped to foster an ideological assault on the post-war Keynesian social democratic WELFARE STATE from the political economy of the New Right, most notably in the United Kingdom and the United States. Drawing on a combination of liberalism and conservatism, the New Right asserted that faltering economic performance and diminished state authority, both at home and abroad, could be attributed, on one hand, to the weaknesses of the mixed economy (which had mistakenly substituted state intervention for individual entrepreneurial initiative in open markets as the prime agency of social change) and, on the other hand, the moral relativism fostered by the welfare state at home and insufficient defence spending and a passive foreign policy abroad, in the face of communist rearmament. At the end of the 1980s, the collapse of communism and the apparent demise of the Hayekian 'road to serfdom' provided by central planning provided the highwater mark of New Right triumphalism. However, despite a resurgence of social democratic governments during the 1990s, the ideology and policy prescriptions of the New Right have become a central component of the discourse of contemporary political economy.

Among the pioneers of IPE was SUSAN STRANGE, who sought to identify

a way to synthesize politics and economics by means of structural analysis of the effects of states – or more properly of any kind of political authority – on markets and, conversely, of markets on states.

(Strange, 1988: 14)

Her purpose was the creation of

a framework of analysis, a method of diagnosis of the human condition as it is, or as it was, affected by economic, political and social circumstances.

(ibid.: 16)

From her attempts to create a new synthesis, Strange defined the new discipline of IPE as being concerned with 'the social, political and economic arrangements affecting the global systems of production, exchange and distribution, and the mix of values reflected therein' (ibid.: 18). More recently, but in a similar vein, Geoffrey Underhill has defined IPE as an exploration of the interactive relationships

between domestic and international levels of analysis; between economic issues and political conflict; and between institutional patterns and economic structures, on the one hand, and the politics that takes place within them, on the other.

(Underhill, 1994: 23)

Strange asserted that IPE must be closely concerned with causes so as to be able to explain the consequences today for individuals, states and corporations of events in the past. Therefore, IPE must be sensitive both to the political and economic history of contemporary events, and also to the future possibilities for remedying today's problems. IPE must therefore encompass not only a reflective, analytical approach to discover what has happened and why, but also a normative, prescriptive approach, thereby identifying what should happen (Strange, 1988: 18–19). Perhaps Strange's most important insight was to remind IPE scholars that political economy is inextricably concerned with the nature and exercise of POWER, be it economic or political or both. Thus, not only should IPE identify where authority is located in a particular context and who has exercised power, but also ask why and whether that individual, public institution or private corporation should possess such power.

From this perspective, Strange was able to develop an approach to IPE which has asserted that while relational power (that is, the power of one actor to get another to do something it would not otherwise have done) has remained important to the study of political economy, it has been increasingly displaced by the exercise of structural power, where structural power is

the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate.

(ibid.: 24–5)

For Strange, structural power emanates from those with the capacity to exercise ‘control over security; control over production; control over credit; and control over knowledge, beliefs and ideas’ (ibid.: 26). As a consequence, the legitimate field of enquiry for IPE should include not only political economy’s traditional concern with the economics of production and finance, but also extend to a detailed analysis of the implications of security issues and intellectual property on the development of the market.

Despite Strange’s attempts to clarify an agenda for IPE, the transition from national political economy to IPE has not been without its difficulties. IPE has brought together the separate disciplines of political economy (largely populated by economists and political scientists preoccupied with domestic events) and IR (largely composed of social scientists whose focus of enquiry has been international and global processes beyond the nation-state). Each discipline has brought to the hybrid IPE its own distinctive language, concepts and methodologies. The establishment and consolidation of a common agenda for IPE has yet to be accomplished. For example, there have been calls for the ‘P’ to be put back into IPE: it has been suggested that conceptions of the political within the discipline of IPE have tended ‘either to be implicit, intuitive and often pre-theoretical or, where more explicit and theoretical, unduly narrow and restrictive’ (Hay and Marsh, 1999: 5).

It also has been contended that IPE should privilege neither the economic nor the political, nor raise the domestic above the international, transnational or global. To be able to capture the great complexity and dynamic aspects of the contemporary global economy, conceptions of the political in IPE should avoid STATISM

and/or INSTITUTIONALISM in order to place greater emphasis on politics as context, process and conduct. Thus the future of IPE would appear to reside with ‘a multidimensional approach privileging no single moment in the complex interplay of political, economic and cultural factors’ (ibid.: 7–9). This approach will regard the private, extra-governmental and societal spheres as being equally legitimate arenas for exploration as the public, governmental and state spheres. Therefore, the challenge for those preoccupied with domestic political economy is to recognize ‘the international conditions of domestic political and economic dynamics’, while the challenge for those from an IR background is to recognize ‘the domestic conditions of international/global political and economic relations’ (ibid.: 14).

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SIMON LEE

political individualism

Opponents and proponents alike see 'individualism' as epitomizing the modern social condition, the natural result of the breakdown of a traditional and hierarchical society of ranks. The word originated as a term of abuse among conservative critics of the French revolution. Though the first known usage was by Joseph de Maistre to attack 'this deep and frightening division of minds, this infinite fragmentation of all doctrines, political protestantism carried to the most absolute individualism', similar sentiments had been expressed earlier by Edmund Burke and other counter-revolutionary thinkers. These criticisms were later picked up by socialists and given a more positive reading by liberals.

Conservative critics associated the individualist mentality with the faith in rationality of the enlightenment thinkers, on one hand, and commercial morality, on the other. Both elements were regarded as flawed and pernicious, the cause and the product of the collapse of the *ancien régime*. The first involved a hubristic belief in the sufficiency of individual reason and a concomitant disdain for custom and tradition. The accumulated wisdom of the past was not to be taken on trust. Individuals had a duty and the capacity to verify all opinions for themselves. The political authority of venerable institutions such as the church and the monarchy was similarly suspect. Henceforth, power could only be exercised with the

consent of those subject to it, a view encapsulated in the idea of a social contract. Such notions were seen as unworkable and anarchical. They condemned every individual to reinvent the wheel for themselves and encouraged moral subjectivism. The second was linked to egoism and the pursuit of narrow self-interest. This selfish and instrumental mentality was held to characterize market behaviour. The social duties of charity and due deference to one's betters that were characteristic of a hierarchical and agrarian order, were replaced with a contract between buyers and sellers in which all qualities were reduced to money. A widow's penny might be equal to a millionaire's, but each got only as much as and no more than they could pay for.

These aspects of individualism were often connected to the language of natural or human rights, which formed the dominant political discourse of the French Revolution and the liberal democratic and capitalist regimes that were gradually established in its wake. Unlike conventional and institutional rights originating from custom or positive law, the rights of man were charged with giving individuals claims against society and broader obligations towards others. As such, they were regarded as epitomizing the abstract, asocial and egoistic evils of individualism. These criticisms were subsequently taken up by KARL MARX (notably in 'On the Jewish question') and other socialist critics of the liberal conception of the market and democracy. More recently, communitarian critiques of LIBERALISM – coming from both Left and Right – have voiced similar views.

Many of these attacks are misplaced. Some liberal individualists have expressed views not dissimilar to those criticized: examples include Herbert Spencer and his followers (such as William Sumner Maine) in the nineteenth century, and economic liberals (such as F.A. VON HAYEK and the libertarian New Right) in the twentieth century. Such opinions have been the exception, however. Most liberal individualists were as worried as their critics about the tendency within modern societies for the individual to withdraw into a private realm and ignore the duties of the public sphere. Never-

theless, they were concerned to stress the moral primacy of individuals and the need to protect their interests against the incursions of others, particularly those with political power. A variety of reasons lay behind this priority, with different thinkers drawing on one or more of them according to their broader philosophical commitments. Prime amongst these was autonomy, or the capacity for self-direction. This conception of individualism, often distinguished from the other by being called 'individuality', had its roots among the German Romantics. It stressed the uniqueness as opposed to the isolation of the individual. Individualism so conceived made for a diverse and creative society, but mandated equal respect and concern for the individuality of others.

In some versions, individuality was grounded in a perfectionist ideal of human development. Individuals were held to develop their respective powers in ultimately harmonious ways that together reflected the true interests and potential of humankind. A notion derived from Aristotle, it was elaborated into a theory of organic community by the conservative neo-Hegelian idealists and certain branches of the socialist and Marxist tradition. They habitually opposed their version of individualism to what they characterized as the liberal individualist perspective, but it also informs certain aspects of liberalism. The best known and most influential instances are the account by J.S. MILL in Chapter 3 of *On Liberty* (entitled 'Of individuality') and Emile Durkheim's essay 'Individualism and the intellectuals'. The latter, written during the Dreyfus affair, explicitly rejected the Spencerian notion of egoistic individualism and disputed the conservative claim that modern societies are inherently individualist in that sense. Rather, Mill and Durkheim believed the division of labour promoted a mutually beneficial and complementary individuality. The liberal idealists (such as T.H. Green) and certain recent liberal theorists (like Joseph Raz) have adopted a similar thesis. These thinkers show the often assumed link between methodological and political individualism to be false (see INDIVIDUALISM, METHODOLOGI-

CAL). By stressing the social origins of individualism, they also undercut most of the criticisms levelled at it by conservative and socialist critics.

Though liberal individualists have generally seen democracy and a free-market economy as fostering individual freedom, development and diversity, they have also accepted that a degree of REGULATION might be necessary to avoid the dangers of anarchy and egoism. Democracy might help ensure governments are informed of and cannot ignore individual interests, but it had to be constrained to prevent tyrannous majorities suppressing the rights of minorities; likewise, markets might promote consumer choice and entrepreneurial initiative, but had to be protected against subversion by monopolists, prevented from encroaching on inappropriate areas and supplemented when they failed to provide for individual needs.

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RICHARD BELLAMY

population growth

The appropriateness of policies to regulate population growth and their impact on economic DEVELOPMENT have been subjects of debate for many centuries. World population has grown at an unprecedented rate since the mid-nineteenth century, reaching one billion in

portfolio investment

1850, two billion in 1930, three billion in 1960 and four billion in 1975. In the late 1990s, world population was estimated at over six billion. This growth has been largely due to improvements in basic living conditions, notably healthcare and nutrition. The uncontrolled rate of population growth led the mathematician and political economist THOMAS ROBERT MALTHUS to warn that food supplies would be exceeded if the human population were left unchecked. His vision of an overpopulated world of famine, war and disease became influential in the mid-twentieth century among demographers, environmentalists and the development community.

The precise link between population size and economic/political power is unclear. Historically, some countries (for example, France, Nigeria) have encouraged pronatalist policies in the belief that large populations support political aims or economic development. Other governments (for example, China, India) have strongly supported family planning to facilitate development. In response to demands for increased population assistance, the United Nations Population Fund (UNFPA) was created in 1969, the WORLD BANK began lending for population activities and NON-GOVERNMENTAL ORGANIZATIONS (NGOs) and bilateral aid agencies (see AID, BILATERAL) became active in family-planning programmes.

Disagreement over the optimal size of national and world populations has been strongly apparent at three major UN conferences: Bucharest (1974), Mexico City (1984) and Cairo (1994). The 1974 conference revealed a clear difference between industrialized and developing countries over the need to reduce population growth. Many developing countries argued that development was the best form of contraceptive. By 1984, most countries agreed the need to control population growth, but controversy over abortion-related activities led the US government to reduce its aid for population activities.

The growth of the environmental movement in the late 1980s led to renewed attention on population control as a means of achieving SUSTAINABLE DEVELOPMENT. Fertility rates

were declining in most parts of the world, but overall population growth continued (largely in developing countries). However, developing countries rejected arguments that environmental degradation was due primarily to rapid population growth in their countries. While 90 per cent of births were in the developing world, each individual born in industrialized countries consumed far greater resources. To these debates were added the voices of the women's health movement which, at the International Conference on Population and Development (1994), successfully argued for a shift in emphasis from controlling population growth to reproductive health.

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KELLEY LEE

portfolio investment

Portfolio investment is a form of capital flow in which the investor has no control over how the capital is used. It is increasingly important in the global economic system because more and more countries are enabling such capital flows to take place and reducing barriers that had previously rendered such investment less at-

tractive. The more common form of portfolio investment involves purchasing a financial instrument for a fixed period of time, at the end of which the principal is repaid, while interest at an agreed rate also accrues during the life of the agreement. A less common form is that of buying stocks and shares in individual companies, although this is set to increase in importance proportionately as regulations on such activities are eased internationally and the amount of private capital – from sources such as pension funds – also increases.

Portfolio investment was an important aspect of the development of the New World and indeed of the colonization of Asia and Africa by European powers. The amount of return that is possible on investment is correlated with the risk that is perceived to attach to the investment: consequently, returns would customarily be expected to be higher for investments in unknown or uncertain distant environments and much lower in safer and closer ones, such as Western Europe or North America. Investors or their brokers will generally seek to obtain a 'balanced portfolio', in which high- and low-risk positions combine a satisfactory rate of return with security.

Portfolio investment – like all legal capital flows – is generally welcomed by governments in that it provides stimulus for private and public investment in the domestic economy. However, the rapid movement of flows – whether inward or outward – can have a serious negative impact on EXCHANGE RATE volatility, overheating the economy and creating sudden dramatic reverses when investors' confidence in the rate of return is adversely affected, leading to potential financial crisis. This phenomenon was witnessed in the 1997 Asian economic crisis, when sudden and only partly explicable losses of confidence in the economies of various states led to rapid and massive outflows of capital, with numerous disastrous economic and social effects. As a consequence of these possibilities, policy-makers within governments seek to moderate portfolio investment behaviour in terms of length (maturity) of agreements, ease of mov-

ing capital out of the country and structural composition.

Although defined as having no measure of control over the purchased asset, portfolio investment has attracted concern in countries (such as the United Kingdom) where large, institutional investors are widely believed to be able to wield influence at the boardroom level of firms in which they have taken large positions. Concern centres on the tension that arises from investors' requirements for high and immediate rates of return that may conflict with the long-term growth of the organization and lead to redundancies, reduced investment in human capital/research and development (R&D), and the sale of valuable assets.

See also:

Asian crisis; internationalization

JOHN WALSH

positional goods

A long-held belief was that market mechanisms within a free society would be incapable of the indefinite expansion of the satisfaction of people's needs and wants. It was also believed that the process of satisfying such needs and wants was essentially a positive-sum game, in which the satisfactions of one person did not entail any lack of satisfaction for anyone else. In the mid-1970s, however, Fred Hirsch demonstrated that there was a category of 'goods' that could be directly enjoyed only at the expense of similar enjoyment by others. The most 'perfect' of such goods were those of social or occupational status – where the enjoyment of high social or occupational status rested, definitionally, on others occupying positions of lower social or occupational status: hence 'positional goods'.

Many positional goods are thus socially defined. However, the concept of positional goods can be applied to many, if not all, 'goods' that are in finite supply. Thus, if oxygen became too scarce to support the whole of the existing

positivism

world population, any mechanism of supply for some at the expense of non-supply for others would endow oxygen with positional qualities. A more realistic example of a positional good, however, is that of a house built in a location with an 'unspoilt' natural view. In a relatively crowded country, it is likely that there would be insufficient space within habitable areas to allow everyone to have a house with such an 'unspoilt' view. In practice, then, an 'unspoilt' view would be a positional good acquired at the expense of the 'spoilt' views, and probably relative crowding, of many others.

The example of the 'unspoilt' view, however, illustrates the social character of many positional goods. Only in a society that placed great value on 'unspoilt views' would a house with such a location be deemed particularly desirable. In societies that placed far greater emphasis on community and conviviality, for example, the relative isolation entailed by houses with 'unspoilt' views might reduce their desirability.

Positional goods do, however, remain rife within most societies. The role of private or indeed any form of selective education is a significant example. Here, individual pupils and their families secure the advantages of a degree of exclusivity (and possibly also more expensive forms of education than could be afforded by or for the greater number) directly at the expense of those who are excluded.

Overall, the idea of positional goods introduces a significant complication to simpler views of market processes, but does increase the realism of the resulting view of such processes and their consequences.

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R.J. BARRY JONES

positivism

The term 'positivism' is used in connection with both law and economics. As will be

discussed later in this entry, although legal positivism and economic positivism are generally accepted theories, there is little connection between the two.

Legal positivism is a theory of jurisprudence that attempts to explain the origins or meaning of law. Positivism views law as the straightforward expression of the sovereign. In other words, legal positivist philosophies generally regard law as a matter of social fact and insist on separating law and morals. Developed in England by Jeremy Bentham and John Austin in the eighteenth century, positivism was primarily a reaction to the natural theory of law. The natural theory, developed primarily by Rousseau, Blackstone and others, viewed law as inherent in nature and independent of human action. Thus positivism is directly opposed to natural law, and legal philosophers generally consider the two to be at opposite ends of the jurisprudential spectrum.

Although all positivists believe in the command theory of law, there are actually three different geneses to positivism:

- 1 *Command theory of law*: First propounded by Bentham, and supplemented by J.S. Mill and Austin, the command theory of law takes utility as the foundation of morals. According to Bentham, law is a mechanism that is necessary to ensure happiness for individuals. Unrestrained behaviour of one would justify unrestrained behaviour of everyone, and everyone's happiness would be thereby reduced. Austin provides the most comprehensive formulation of modern analytical positivism. According to him, law is a system of rules promulgated for the guidance of the people by a person having power over them. In this way, law is completely separate from justice. In addition, human laws are divided into (1) positive laws and (2) positive morality; only the former are properly called laws. Furthermore, to Austin, law is a signification of desire.
- 2 *Normative theory of law*: Propounded by Hans Kelsen more than a century after Bentham, it was Kelsen who first wrote

about positivism. Whereas Bentham, Mill and Austin viewed utilitarianism and utility as the philosophical basis of positivism specifically and law more generally, Kelsen is a neo-Kantian. The starting point for Kelsen is the Kantian distinction between cognition and volition, or 'is' and 'ought'. Kelsen views legal theory as science, not volition: the knowledge of what law is, not what it ought to be. Kelsen's theory of law is a formal and universal theory. It is not to be mixed with alien elements of morality and ethics. The legal relation contains the possibility of a sanction from an authority in response to an act. Thus a given act is likely to lead to a certain consequence and only in this sense is law an 'ought'.

- 3 *Rule theory of Law*: The rule theory of law was first espoused by H.L.A. Hart. According to Hart, any society has certain primary rules that impose duties, such as restrictions on the use of violence, theft and so on. Since there are always people desirous of breaking these primary rules, societies also need a set of secondary rules. Hart posits three types of secondary rules as being necessary: (1) rules of recognition, (2) rules of change and (3) rules of adjudication. The primary rules impose duties and the secondary rules confer power. Hart sees the heart of the legal system as being the combination of the primary rules of obligation with the secondary rules of change, recognition and adjudication.

Thus, while all positivists share the same basic premise – that law and morals are separate – there are three different branches of positivism, each with different premises. It should be reiterated that what has been described so far is positivism in a legal sense (legal positivism, not economic positivism).

Economic positivism refers to economic analysis that is descriptive rather than normative. A positive economic analysis says simply that, given a certain set of premises, a particular conclusion will follow. For example, given propositions A, B and C, conclusion D will necessarily result; or, if domestic manu-

facturing is not competitive, quotas on foreign imports will result in higher prices. At the other end of the spectrum, normative economics involves policy choices between alternatives. An example of a normative economic proposition would be that input quotas are bad policy, particularly if domestic manufacturing is not competitive.

In economics, there is a debate over which issues/statements are positive and which are normative. A growing body of economics literature argues that what often pass for positive issues are really normative issues in disguise. Milton Friedman believed the converse. In his famous essay 'The methodology of positive economics' (1953), Friedman argued that many – perhaps even most – disputes that appear to be normative are actually positive. For example, he argued that the minimum wage is really a positive, rather than a normative, controversy. He surmised that economists generally agree on the normative proposition that a livable wage for every worker is a good thing. They differ only on whether the minimum-wage law will achieve this goal. While some economists believe that a minimum wage will guarantee every worker a living wage, others say that minimum-wage regulation will cause unemployment and even greater hardship among the poor. These differences rest on empirical propositions and can be tested. A positive methodology that shows which side of the minimum-wage debate is empirically correct will therefore eliminate the 'normative' controversy.

The successful application of a positive methodology isolates those elements in economic controversy that are strictly normative, while producing consensus about everything else. Positivists describe their methodology as a procedure by which a hypothesis is formulated and then its validity tested by attempting to falsify it through empirical observation. To the extent that a hypothesis cannot be falsified, it is said to be 'robust' or 'predictive'. Friedman advocates such 'positivism' as the method for economics. Under his positivist methodology, the usefulness of a proposition is determined not by its plausibility or verisimilitude, but

post-Fordism

rather by its predictive power. Positive economics is designed to provide a system of generalizations that can be used to make correct predictions about the consequences of any change in circumstances. Its performance is to be judged by the precision, scope and conformity with experience of the predictions it yields.

Although positivism is used both in law and in economics, there is actually little similarity between the two. Whereas economic positivism is concerned largely with prediction, legal positivism seems to be concerned principally with explanation. Thus the legal positivist statement that law is nothing more than a set of rules promulgated by the sovereign is more akin to a normative economic statement, since it cannot be tested and disproven by empirical methodologies.

See also:

rationalism

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Finally, criticisms of each theory are offered.

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STEVEN E. ABRAHAM

POST-COLONIALISM *see* neo-colonialism

post-Fordism

'Post-Fordism' is a much-debated but imprecise concept with multiple meanings, all of which make sense only in relation to the similarly elusive notion of Fordism. The term most commonly denotes a set of interlinked and mutually reinforcing economic, social, political and managerial norms and practices which, some allege, have increasingly underpinned and stabilized economic growth in the advanced capitalist world since the mid-1970s, superseding those of the earlier (Fordist) period.

Origin and development

The term 'Fordism' dates back to the early 1930s. The classical Marxist ANTONIO GRAMSCI used it in analysing why the US economy was outperforming European competitors. Gramsci adjudged the superior productivity of US industry to be based on 'scientific' mass production methods pioneered in Henry Ford's car factories. But Fordism, as a system of industrial organization, proved durable only because various carrots and sticks were introduced which made 'the whole life of the nation revolve around production' and helped produce a new type of worker who was amenable

to physically demanding, uncreative, routinized assembly-line work. The carrots offered to the industrial workforce included high wages (which fuelled mass domestic consumption and high product demand) and social benefits which paved the way to the WELFARE STATE; the sticks included prohibition and other puritanical measures to encourage discipline, monogamy and sobriety among workers.

The concept of Fordism was only fleshed out half a century later when the post-war economic boom that had been enjoyed by the advanced industrial nations faltered and established methods for dealing with economic downturns proved ineffective: that is, when Fordism in a wider sense went into crisis. REGULATION THEORY, largely developed by neo-Marxists, expanded two of Gramsci's key ideas. First, it acknowledged that a 'successful' and stable system of (post-)industrial production depends on a range of economic, political, social and cultural support mechanisms. Second, it argued that there is not a single, unchanging form of capitalism, but many types of capitalist economic regime which vary over time, across space and in their effectiveness at organizing long-run wealth-creation.

Regulation theorists view Fordism as the system of economic organization, adopted in various national contexts, which underpinned post-war prosperity. Definitions vary, but Fordism is usually seen as comprising three elements: (1) a labour process dominated by the mass production of standardized goods by large monopolistic corporations which benefited from ECONOMIES OF SCALE, (2) a 'REGIME OF ACCUMULATION' in which there was a virtuous circle linking the productivity gains of mass production to high wages, high demand, full utilization of economic capacity, increased investment, incremental technological innovation and further productivity gains, and (3) a 'MODE OF REGULATION' in which nation-states sustained economic growth through Keynesian demand management (see KEYNESIAN ECONOMICS), national arrangements for agreeing 'affordable' wage levels with organized labour and a comprehensive welfare system.

Fordism is generally argued to have been destabilized by economic GLOBALIZATION. Economic growth in the 'core' advanced capitalist countries faltered as markets for undifferentiated mass products became saturated and MULTINATIONAL CORPORATIONS (MNCs), seeking higher profits, decentralized production to less-developed areas of the globe where costs were lower. This helped sow the seeds of fiercer global economic competition which, in turn, had an impact in core countries on the structure and fortunes of key firms, on employment and income levels, and on the costs of social welfare. The priorities and modus operandi of nation-states were also challenged by globalization. In particular, the complex system of trading interdependencies created by an increasingly global system of production, distribution and exchange meant that nation-specific Keynesian demand management was increasingly ineffective, largely because there was less and less chance that the benefits of increased consumption in one country would be captured by producers in that country.

The post-Fordist debate grew out of regulation theory's analysis of Fordism, although it was by no means dominated by regulation theorists. Effectively, it asked how the crisis of advanced industrial nations was being, or could be, resolved. Just as there is no consensus on the answer to that question, so there are different variants of post-Fordism. Three alternative understandings illustrate that variation. Two of the alternatives – let us call them 'after-Fordism' and 'extended post-Fordism' – insist that Fordism's successor must logically have characteristics which mirror all those of Fordism. A third alternative – which we will term 'industrial post-Fordism' – offers a narrower, economic perspective.

After-Fordism emphasizes the 'post' in post-Fordism and argues that the period after Fordism has not witnessed the evolution of a new and distinctive labour process, regime of accumulation or mode of regulation. On this definition, post-Fordism is not a stable regime which superseded Fordism, but an era of restless economic and political experimentation

in which (to paraphrase Gramsci) the old is dead but the features of the new are not yet visible.

Industrial post-Fordism, by contrast, emphasizes the newness of a distinctive system of production – often termed ‘flexible specialization’ – but makes few links between it and old or new forms of political and social regulation. Flexible specialization is said to transcend the limitations of Fordist mass production. The flexible post-Fordist firm, it is argued, utilizes advanced technology in providing for niche markets. It is highly responsive to customers, and can modify and tailor its products to them far more quickly than its Fordist predecessors. It utilizes economies of scope, not of scale. It is less hierarchical in its structure and management, and demands high levels of creativity from its skilled workforce. It is also likely to be part of a network of innovative producers whose interdependencies and export potential can provide a firm basis for the reinvigoration of local and regional economies. On this view, the transition to post-Fordist forms of industrial organization – which often bear a strong resemblance to pre-Fordist craft-based forms – has enormous and largely beneficial implications for consumers, workers and industrial relations, and significant potential for forms of economic renewal which rely less on national adjustments in public expenditure and FISCAL POLICY.

Flexible production methods are taken to underpin a new labour process in extended post-Fordism. However, in this variant they are allegedly supported by an emerging post-Fordist regime of accumulation and mode of regulation. The post-Fordist regime of accumulation is based on a more restricted virtuous circle in which (1) substantial technological advances, based on new information technologies, underpin product and process innovations in firms geared to servicing global markets, (2) huge rewards, largely unregulated by the state, are available to core groups of highly skilled, flexible and mainly non-unionized workers, (3) demand grows for highly differentiated products and services, and (4) investment flows back into research and development (R&D) to

support further technological innovation. In the post-Fordist mode of regulation, the state supports the new accumulation regime by emphasizing supply-side improvements to economic competitiveness, often at the local and regional scale, rather than national demand management. National policies support labour market flexibility and the welfare state is remodelled to provide residual support for the economically inactive and pathways into employment – for example, through ‘workfare’ programmes – for the economically active.

Debate

Although the debate has lost impetus in recent years, the notion of post-Fordism originally proved extremely controversial. Vigorous internal debate took place between adherents of the three variants of post-Fordism identified above. Tensions were obviously most acute between after-Fordism and extended post-Fordism, whose main arguments were polar opposites. But adherents of these two approaches also took issue with industrial post-Fordists on the basis that their arguments about the liberating effects of flexible production methods were partial and naively optimistic. On one hand, it was argued that industrial post-Fordists had based their vision of the future of work as liberating and creative on a small number of examples of ‘new industrial spaces’ – particularly in the so-called Third Italy, in Baden-Württemberg and in the high-tech United States – which were neither representative nor particularly similar.

On the other hand, questions were raised as to the overall desirability of increased labour flexibility. For the critics, the freedom enjoyed by relatively privileged, highly skilled workers engaged in technologically advanced manufacturing and service industries represented just one (rather less important) face of post-Fordist labour flexibility. The life chances of a much broader range of unskilled workers were affected by a process of labour-market polarization in which the benefits of flexibility accrued to employers, not employees. The rapid expansion of part-time, insecure, poorly

rewarded work in personal services and consumer industries – occupations which helped provide for the needs of the post-Fordist labour aristocracy – was argued by many to be just as important a feature of post-Fordist production, but one with much bleaker social implications.

External critics of post-Fordism, on the other hand, questioned the utility of any analysis of the evolution of capitalism which adopted a very crude periodization of history and claimed to identify a sudden transition from one distinct epoch to another. This line of attack involved disputing the relevance of the Fordist as well as the post-Fordist label, but the latter was seen as particularly vulnerable because its main features were specified much more loosely and less confidently. So, with respect to the labour process and the regime of accumulation (for example), critics questioned how many sectors of Fordist industry there really were, whether they truly dominated national economies in the Fordist period and, paradoxically, whether they had changed very substantially or played a significantly less important role in the post-Fordist era. Was it not the case, asked commentators who adopted a more sophisticated historical approach to the development of capitalism, that mass production and FLEXIBLE ACCUMULATION have long existed alongside one another?

Fundamental questions were also raised about whether the IDEAL TYPES used to characterize the modes of regulation operating in the Fordist and post-Fordist periods were helpful in analysing the experience of all advanced capitalist countries. Critics argued that on critical questions such as the form of the welfare state, the dominance of particular approaches to macro-economic management and national systems of wage determination, there was infinitely more variety over time and between nations than the Fordist/post-Fordist dichotomy allowed. Japan was offered as the single most problematic case: it did not fit very easily into either the Fordist or post-Fordist mould. Post-Fordist theorists countered by introducing further terms (such as 'flawed Fordism') to cater for greater historical and geographical variation. But in doing so they

played into the hands of critics who argued that a full understanding of the dynamics of capitalism had to proceed on detailed historical and cross-national empirical research.

The post-Fordism debate remained unresolved, largely because there was insufficient evidence that it could address the wide range of real world experiences with different models of capitalism. Although early regulation theories drew extensively on country-specific historical material, their nuances generally went astray in abstract debates about the oversimplified models represented by Fordism and post-Fordism. Ultimately, the one area of consensus centred on the banal observation that technological, economic, political, managerial and social change are intimately interrelated. But quite how, why and in what circumstances is something post-Fordism was no better equipped to address than rival approaches in political economy. The term is mostly used now for its heuristic, rather than 'scientific' value. The concept of post-Fordism nonetheless continues to inform fragmented but interesting and more empirically informed work, especially on cross-national trends in welfare state reform and the role of subregional levels of governance in economic modernization.

See also:

Fordism, crisis of

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post-industrialism

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ALAN HARDING

post-industrialism

During the 1960s and early 1970s, the rise of the service sector relative to manufacturing in the developed states' economies prompted some sociologists to propose the emergence of a 'post-industrial' form of economic organization. Following the agrarian and industrial revolutions, post-industrialism suggested a third revolution was taking place, which would transform the way society was organized. However, the assumption of continued widespread prosperity and ECONOMIC GROWTH that underlay many post-industrial forecasts was subsequently overshadowed by the upheavals of the mid-1970s. More recently, similar forecasts have once again begun to find favour as political economists have identified the emergence of an information economy and its associated KNOWLEDGE INDUSTRIES as part of the process of GLOBALIZATION (see INFORMATION SOCIETY/ECONOMY).

Post-industrialism in the 1960s and early 1970s was predicated on the emergence of a highly developed international division of labour (see DIVISION OF LABOUR, INTERNATIONAL). While the rich states and their economies might become post-industrial in organization, they were unlikely to consume significantly less material goods. Indeed, the prosperity of the post-industrial society would be partly delivered by an increase in productivity resulting from the further application of innovative computer-controlled manufacturing. This was allied to the production of

consumer goods in developing (and thus low-labour cost) locations outside the most developed economies. Thus post-industrialism assumed both increased productivity at home (to allow displaced workers to enter post-industrial occupations) and the movement of production to LESS-DEVELOPED COUNTRIES (LDCs) that would remain largely industrial societies. Broadly speaking, high-technology goods would be produced in the developed countries while more labour-intensive products would be imported. Implicitly adopting product-cycle theory (see PRODUCT-CYCLE MODEL), post-industrialism assumed that as industries matured their production processes could be transferred to low-cost production sites in DEVELOPING COUNTRIES.

Post-industrialism therefore identifies three significant social changes or revolutions in the most developed states. Major shifts were taking place in (1) productive activity, (2) occupational character and (3) technological structure. Economic activities would become less concerned with the manipulation and combination of material inputs, and would move to the manipulation of knowledge and information. This was represented by the relative rise of service occupations and, to some extent, echoes the arguments for the rise of managerialism posited in the 1950s. Services were expanding exponentially, leading to a change in the general character of employment. There would be a move from blue-collar to white-collar work, and to correspondingly more pleasant working conditions and greater job satisfaction. Writing as the early information technologies were emerging, post-industrialism recognized that powerful computing would greatly influence future technological advances. Once information collection and manipulation were automated, increasing value would be put on analytical and higher-order knowledge skills. The technological structure would no longer be founded on the combination of material inputs, but would now prioritize the application of theoretical and analytical knowledge to economic activities. All of these transformations were, Daniel Bell (1974) and others argued, broadly beneficial for society

and would enhance the QUALITY OF LIFE of the population in post-industrial states.

Not all commentators adopted this positive gloss on the changes. Critics of the optimistic assumptions of the post-industrialists suggested that the enjoyment of the advantages of knowledge would be unevenly distributed through society and there were likely to be conflicts between those whose knowledge was based on humanistic foundations and those who developed the more valued technical or scientific knowledge (Touraine, 1974). Additionally, critics on the Left argued that post-industrial economic organization would reproduce CAPITALISM with the same problems of CLASS STRUGGLE and inequality, not fundamentally transform society; those who were displaced by technological improvements in productivity and who did not have the skills needed to join the service class (see CLASS, SERVICE), might find themselves surplus to society's requirements. In the 1990s, many of the analyses of post-industrialism have been revived in discussions of the information economy and POST-FORDISM, but it remains to be seen if these forecasts will outlive any downturn in the global economy similar to that which marginalized post-industrialism.

See also:

deindustrialization; industrial revolution, third

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CHRISTOPHER MAY

post-Keynesian economics

This entry attempts to present the major characteristics of post-Keynesian economics. Post-Keynesian economics represents a positive statement of methodology, ideology and content. Post-Keynesians are united not just because of their critical attitude to NEO-CLASSICAL ECONOMICS, but more importantly because of their attempt to provide an additional paradigm to that of orthodox economics. This entry aims to show that post-Keynesian economics constitutes a new approach to our understanding of economic phenomena. This exploration begins with methodology, followed by an attempt to summarize the main theoretical issues, before the implications for economic policy are briefly discussed.

Methodological issues

The most important methodological issue is that a free market economic process is inherently unstable and generates forces within the system that are responsible for the instability and fluctuations in economic activity. Theories should represent economic reality as accurately as possible, and should successfully account for and explain economic reality. Post-Keynesian theory begins with observation and proceeds to build on 'realistic abstractions' rather than 'imaginary models'. As such, it utilizes the depth of explanatory power and the ability to elucidate a range of empirical phenomena as criteria of theory adequacy, without ignoring predictive accuracy.

Econometric modelling is taken seriously by

most post-Keynesians. The frequent reference to stylized facts and, in general terms, the empirical tradition of post-Keynesianism clearly imply that the econometric tool of analysis could be employed usefully. But the precise form econometrics should take is, like theory, diverse and context-specific. The realist view held in this context implies that 'econometric science' is possible, but it must be explanatory in addition to being predictive. Econometrics is thought to be more valuable when used prudently to identify structural changes with the help of models which, nonetheless, should be continuously revised as new evidence emerges.

When REALISM is shown to be at the heart of post-Keynesian methodology, it becomes inevitable that history and institutions are an integral part of such methodology, as is an organic (rather than an atomistic) approach to economic processes. These propositions facilitate the analysis of the role played by dominant institutions and imperfect markets. These considerations have profound implications in terms of post-Keynesian economic theory, especially when we come to the vital question of the central concerns of this economics: production and distribution. Post-Keynesian analysis takes the scarcity of demand seriously, as well as that of scarcity of resources, but 'effective demand' assumes a central position in it. The role of exchange is such that individual choice is limited, for it is determined by income, class and the technical conditions of production, rather than by relative prices. Consumer choice is based on lexicographic ordering – that is to say, on a hierarchy of needs. This implies that the demand for goods depends on the social income or class of consumers. Income and not substitution effects, along with income distribution among social classes, are the objects of analysis.

In the sphere of production, monopolies and oligopolies assume socio-political as much as economic power in product markets, which gives them the prerogative to administer prices. This capacity relative to the power over input costs (especially wage costs) determines the

surplus that monopolies and oligopolies can master. It is this surplus which, when translated into investment, provides the engine for growth. The extent to which the surplus is translated into investment depends on expectations: these are both long-term expectations about the health of product markets and short-term expectations that relate to the prices of financial assets. These prices are essentially determined by social relations, themselves influenced by the relative power of financial institutions.

Uncertainty is, of course, of immense importance in the real world and, as such, one of the central elements of post-Keynesian analysis. Such uncertainty implies that the future is unknowable and unpredictable and that consequently economic agents' expectations can easily be frustrated. Market forces cannot account for the unknowability and unpredictability of the future, and so can only disseminate incomplete information. The prices of goods and services today cannot tell buyers and sellers what the consequences of their collective actions will be on prices tomorrow. In an uncertain world, all they can do is to assume that if they have been happy with their actions in the past they are likely to be so in the future. Since 'knowledge' of the future can only be formed from past events, it follows that it is only 'indirect knowledge' that can be held concerning the future. But such knowledge of the future can be ascertained with only a probable degree of certainty. Now, the conditions under which such a probability can be calculated are rarely met in everyday life. Consequently, in general terms, probabilities of this type cannot be arrived at.

Related to uncertainty are the notions of irreversible time – that production takes time and that economic agents enter into commitments well before outcomes can be predicted. Economic agents, therefore, commit themselves to contracts denominated in money, so that money and contracts are intimately and inevitably linked. In this sense, the importance of money is that it is a link between the past and the present, and also between the present and the future. Post-Keynesian analysis is thus

crucially concerned with historical time as distinct from logical time. Essentially, the importance of emphasizing historical time in an economic system is that its past is given and cannot be changed, and that the future is totally uncertain and consequently unknown. It is precisely this kind of uncertainty, inherent in historical time, that is both a necessary and a sufficient condition for the existence of money.

Post-Keynesian economics is fundamentally concerned with DISEQUILIBRIUM analysis, with an emphasis on change over time. In such a framework, growth and dynamics are central parts, so that the explanation of the erratic nature of the expansion path of a capitalist economy becomes the main focus of analysis. And the driving force behind the erratic expansion path of the economic system is INVESTMENT.

Main theoretical constructs

There are a number of key theoretical propositions which underpin the post-Keynesian framework of analysis. There is, to begin with, pricing theory within the capitalist MODE OF PRODUCTION. An essential characteristic of this mode is that social relationships are of paramount importance in production. This is so because the output produced by one class of society (the wage earners) is planned, directed and managed by another class of society that does not participate directly in production (the recipients of residual income profit). In this power relationship, capital's objectives are in conflict with labour's objectives, so 'class conflict' is at the heart of analysis. Modern advanced industrial societies are characterized by the duality of the 'competitive' and the 'oligopolistic' sectors. The 'competitive' sector portrays the type of behaviour typical of the neo-classical firm (where demand and supply determine price), so that firms are price-takers. The 'corporate revolution' has produced the notion of the 'megacorp' and the 'oligopolistic' sector. This has meant that the megacorp has replaced the neo-classical type firm and has become the dominant form of enterprise in modern advanced industrial societies. The

pricing behaviour of the megacorp is simply to add a certain percentage mark-up on their unit cost of production. The mark-up is determined by what the megacorps need to finance their investment plans. It follows from this analysis that pricing theory is inevitably and inextricably linked to the theory of investment and class conflict.

Investment in the post-Keynesian tradition is determined by 'expected profitability'. But it is recognized that while it is expected profitability that induces capital accumulation, realized investment creates the profitability which makes investment possible – partly through internally generated funds. Expected profitability is essentially influenced by two sets of factors: first, the expected rate of return on investment (or, in other words, the marginal efficiency of investment), which gives rise to interest rates; second, the expected growth of sales. The first factor is more appropriate as a determinant of investment expenditure undertaken by a megacorp on equipment that is designed to reduce costs (research and development being the typical item in this category) and on equipment that would enable the megacorp to create barriers to entry into their sector. The expected growth of sales or income is a more relevant explanatory variable of investment expenditure on new plant and equipment that puts the megacorp in a strong position to satisfy the expected demand for its products when that demand materializes. This category accounts for most of total investment expenditure, so it is expected sales or income that becomes by far the most fundamental determinant of total investment. The pervasive nature of expectations under uncertainty that influences entrepreneurs' 'animal spirits' plays a part of vital importance in the capital accumulation process. So much so that the volatility of expectations under uncertainty is thought to lead to structural breaks and crises.

Investment, in its turn, is the most important variable in distribution theory. This theory recognizes that national income is divided into total wage income (the wages and salaries that workers receive for their labour services) and total profits (capitalists' income, earned

through the ownership of the means of production). It is also assumed that marginal propensities to consume out of wages and profits differ, from which it follows that on a steady-state growth path the shares of profits and wages are related to the marginal propensities to consume and, most importantly, to the ratio of investment to income. Control over the rate of investment implies control over the distribution and the rate of profit. Distribution and investment, now, are the fundamental features of growth dynamics.

Growth dynamics is at the heart of post-Keynesian analysis, a feature which emanates from the post-Keynesian concern with an economic system that is expanding over time in the context of history. The dynamic element is derived from the modification of the rate of growth of national income (the ratio of AVERAGE PROPENSITY TO SAVE (APS) to the capital/output ratio) to take account of the contention that the average propensity to save is affected by income distribution, whereby propensities to save out of profits and wages differ. This approach requires two types of analyses: a long-run and a short-run analysis. The long-run analysis concerns itself with the 'secular' or 'trend' developments of the economy; the short-run analysis attempts to explain the 'cyclical behaviour' of the economy, which can only be understood in relation to the 'secular' developments from which it represents a deviation. Post-Keynesian analysis concerns itself with the study of both of these phenomena. In doing so, it recognizes that trend and cycle are in fact interdependent.

The fundamental starting point of post-Keynesian business cycle theory is that cycles are viewed as an inherent aspect of capitalist economies. BUSINESS CYCLES are thus depicted as being endogenous phenomena caused by the normal functioning of the capitalist economic system. Exogenous shocks (like, for example, technological innovations, oil price changes and so on) can spark off cyclical fluctuations, but they simply accentuate an underlying endogenously embedded instability. This instability arises from the motive of producers and financial investors alike to accumulate

wealth for its own sake. It is, therefore, not surprising to find that investment and expectations are at the heart of post-Keynesian business cycle theory. To demonstrate, let us assume that the economy is on the upswing of the cycle. Expectations of returns on investment and profits are optimistic, so that demand for liquidity is low and commercial banks are more willing to lend than otherwise. Investment is boosted substantially and the economy is on a healthy growth path. Improved profitability, however, carries the seeds of its own destruction, engendering a too rigorous expansion of output and employment, thus reducing the reserve army of labour and strengthening labour bargaining power. As expansion comes to an end, the process goes into reverse. This is characterized by lower-than-expected returns and high interest costs, so that profits and investment take a turn for the worse. Markets become less active and commercial banks are less willing to extend credit. The economy is well on its way to the downswing.

'Class conflict' in post-Keynesian economics is most pronounced in wage determination theory, in which bargaining is the kernel of the analysis. Unionized or non-unionized workers have drives and aspirations, as well as economic and political power, which are described in terms of a target relative to real wages. Deviations of actual real wages from the desired level affect the level of money wage demands, causing an upward pressure on money wages if the desired level is greater than the actual level. Similarly, there would be a downward pressure on money wages when the real wage falls short of the target relative real wage. Expectations of price INFLATION over the contract period, the rate of change of unemployment seen as a proxy of the speed of expansion or contraction of 'the reserve army of unemployed', and the workers' position in the income distribution relative to certain reference groups, are further variables thought to be important determinants of nominal wages. Now, the rate of wage inflation relative to productivity (along with that of prices of imports and raw materials) are taken to be the

most vital determinants of price inflation. It clearly is the case, then, that the theory of inflation alluded to by post-Keynesians belongs squarely in the 'conflict theory' framework, reflecting the struggle of labour for its income share.

The monetary and financial aspects are as central to the paradigm. Money is viewed as essentially endogenous in a credit money economy. Its behaviour is governed by portfolio needs of firms, people, governments and financial institutions. It is clearly the case that money responds to the behaviour of private economic agents rather than, mainly, to the behaviour of the monetary authorities. The emphasis, then, in post-Keynesian monetary and financial analysis is on credit, rather than on money, in enabling spending units to bridge any gap between their desired level of discretionary spending and the current rate of cash flow. Money, therefore, is completely integrated within production and exchange, so that any attempt to curtail the required flow of money will produce severe cutbacks in production. Monetary authorities, though, should aim to create the financial stability that is so important to discourage the use of funds for speculation rather than productive activity. However, when speculation causes liquidity to increase excessively, direct credit controls should be used to curb it.

Monetary authorities can control the discount rate, changes in which directly influence changes in the market interest rates via a markup. It is the rate of interest that is viewed as being the control variable in this approach. In addition, the discount rate (as determined by the monetary authorities) affects the exchange rate. This link brings to the fore the foreign-sector aspects of the economic system in the case of open economies (see OPEN ECONOMY). These aspects are incorporated into the analysis through the current and capital accounts of the BALANCE OF PAYMENTS: the exchange rate influences and is influenced by the state of both accounts. A novel feature of the imports element of the current account is the hypothesis embedded in it that suggests that the marginal propensity to import out of workers'

income and out of capitalists' income differs. This is, of course, an extension of the idea referred to above in terms of distinguishing income classes in consumption.

Economic policy implications

The position taken by most post-Keynesians on the question of economic policies is that market forces do not reduce the inevitable inequalities that exist in a capitalist system. Market forces tend to exacerbate the disparities that are evident in such a system. Post-Keynesians point to the real world to demonstrate that there are, in fact, persistent economic disparities and that markets do, in fact, perpetuate inequalities. The capitalist economic system, based on free-market principles, is thus inherently cyclical and unstable. Left to itself, it would not achieve (let alone maintain) the full use of existing resources, nor their equitable distribution. These features of the capitalist system are mainly due to the behaviour of private investment, which is attributed to volatile expectations and business confidence. Under these circumstances, full-employment is the exception rather than the rule. But even if achieved, it is not likely to be sustained without government intervention.

There is, therefore, a potential role for government in initiating, pursuing and implementing economic policies. Central to these policies is management of aggregate demand. Full employment is not the only objective of post-Keynesian economic policy: governments should also strive to promote a more equal distribution of market power, and thus of income and wealth. It should also be noted at this juncture that a completely 'free' market system does not actually exist: government intervention and appropriate institutions have evolved with the specific aim of reducing the fluctuations that are inherent in a 'free' market system. Despite attempts in certain countries (the United Kingdom in the 1980s is the best example) to 'roll back the state', the trend in the twentieth century has been for more government intervention, not less. Post-Keynesians recognize that there are severe

post-modernism

obstacles to reaching the goals referred to above. It is for this reason that, in addition to demand management, post-Keynesians also propound supply-enhancing types of policies.

Further reading

Arestis, P. (1992) *The Post-Keynesian Approach to Economics: An Alternative Analysis of Economic Theory and Policy*, Aldershot: Edward Elgar. Discusses further the issues raised in this entry.

— (1997) *Money, Pricing, Distribution and Economic Integration*, London: Macmillan. Several post-Keynesian theoretical propositions are applied in a number of ways.

Eicher, A.S. (1976) *The Megacorp and Oligopoly: Micro Foundations and Macro Dynamics*, Cambridge: Cambridge University Press. Provides a full coverage of the importance of the 'megacorp' in post-Keynesian analysis.

PHILIP ARESTIS

post-modernism

Post-modernism is one of the greatest intellectual challenges to established knowledge in the twentieth century. Originating in the humanities, it is both a loose paradigm and a philosophical orientation. It features epistemological uncertainty, non-linear ways of thinking, intuitive interpretation and an infinity of readings of any text (everything is a 'text'). It is made up of an eclectic combination of views from other philosophical approaches, including existentialism, hermeneutics, populism, phenomenology, Romanticism, French STRUCTURALISM, nihilism, Western Marxism (see MARXISM–LENINISM), CRITICAL THEORY and anarchism. While it shares something with each of these, it also disagrees with all of them on other points. Post-modernism calls into question the underlying assumptions essential to traditional economics and much of political economy: scientific enquiry, objective knowledge, technological progress, linear economic

history, truth claims, Western RATIONALITY, reason, humanism (inasmuch as it puts people at the centre of analysis) and so on. Post-modernism offers a creative and innovative approach in the humanities. The literary works of Umberto Eco, Salman Rushdie, Milorad Pavić and Italo Calvino are excellent examples. But the consequences of a post-modern analysis in the social sciences are more serious, and some critics argue it is frivolous and irresponsible.

In political economy, post-modernism takes moderate formulations and is sometimes viewed as a successor or complement to MARXIAN ECONOMICS. Whatever the case, it seeks to broaden rather than undermine knowledge-building. McCloskey's pioneering work is an example. Post-modern political economists advance relativistic, institutional approaches to economics and develop new views of the market. They seek to 'deconstruct' and seriously criticize mainstream economics (see NEO-CLASSICAL ECONOMICS; KEYNESIAN ECONOMICS) and more orthodox political economy. They question EQUILIBRIUM THEORY, empirical testing, replication and the appropriateness of accepted statistical approaches in econometrics. They emphasize relevance, value judgments, cultural dimensions, anti-essentialism, metaphysics, interpretive approaches, the plural and fragmented character of reality, intersubjective views of self and product, the centrality of language, the significance of discourse, and gender equality in economics.

See also:

post-rationalist international political economy

Further reading

Backhouse, R., Dudley-Evans, T. and Henderson, W. (eds) (1993) *Economics and Language*, London: Routledge.

Callari, A., Ruccio, D. and Althusser, L. (eds) (1996) *Postmodern Materialism and the Future of Marxist Theory: Essays in the Althusserian Tradition*, Middletown, CT: Wesleyan University Press.

- Gerrard, B. (ed.) (1993) *The Economics of Rationality*, London: Routledge.
- Klamer, A., McCloskey, D. and Solow, R. (eds) (1988) *The Consequences of Economic Rhetoric*, Cambridge: Cambridge University Press.
- McCloskey, D. (1985) *The Rhetoric of Economics*, Madison, WI: University of Wisconsin Press. Classic of post-modern economic analysis.
- Rosenau, P.M. (1992) *Post-Modernism and the Social Sciences*, Princeton, NJ: Princeton University Press. General introduction.
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PAULINE VAILLANCOURT ROSENAU

post-rationalist international political economy

Let us begin with some conundrums – dare we say ‘irrationalities’ – in international relations (IR). Why, for example, is it that at a time of undisputed global dominance of markets, states and societies by transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)), these corporations feel an ever stronger need to legitimate themselves and their actions (Thrift, 1998)? Why is it that every successive stage of LIBERALIZATION, promising market autonomy and individual freedom, has come with a battery of rules and instruments of surveillance and regulation (Gill, 1995)? Why is it that the triumph of CAPITALISM – marked by the end of the COLD WAR and the commodification of human life everywhere – brings an increasing sense of insecurity, not only among labour and the new converts, but also among capitalists and their cronies? Why is the undisputed global power and influence of America and Americanism coupled with hegemonic terror of waning significance and global disorder? Is it not a paradox that a world increasingly dominated by a unitary system-logic and by rationally maximizing institutions *appears* to be at the

same time so irrational, unpredictable and insecure?

International political economy (IPE) has tended to steer clear of such conundrums, tending to assume order and rational behaviour in the transnational economic and political system. IPE rejects the state-centrism of mainstream IR thought in preference for a framework that stresses the inseparability of economic and political processes, the salience of non-state actors such as firms and the primacy of transnational fields of influence over inter-state relations.

Ironically though, despite these major differences regarding the basic unit of organization and analysis (for example, political actors versus firms, states and markets; states versus world system), IPE shares with IR a common rationalist set of assumptions. For instance, both assume as a constant that the international system and its players are rational. Within IPE, actors such as the state or transnational firms are assumed to be rational calculating actors, with clear – usually utility-maximizing – preferences and goals (from power to profits). Differences in opinion tend to focus on whether the actors are individuals or institutions and whether or not the choices are constrained by information and knowledge gaps or uncertainty. But the core principle of RATIONAL CHOICE remains undisputed. At the opposite end of the spectrum of approaches in IPE, lie those which stress the powers of the system over individuals and institutions. But here too, the principle of rationality remains central. Whether hegemons seeking to maintain themselves or global capitalism awarding particular functions to states, markets and non-state institutions, in both cases a machine-like logic with its own imperatives sets the terms in which international affairs are conducted. This logic – usually the need to preserve and expand capitalist relations of ownership, exchange and growth – consists of universal rules to preserve the integrity of the system. Thus the rationality of the system (the assumption that the international system is patterned in a logical way) complements the rationality of the actors (the assumption that the actors are pursuing

rational goals) and the two rationalities sustain a rationalist epistemology (the assumption that reality can be apprehended adequately through logical abstraction).

A rationalist epistemology cannot cope seriously with the conundrums above, because each one challenges its core assumptions. Consequently, IPE would tend to discard them as noise on the margins, as irrational outcomes that do not alter the rationalist ontology. But what if these irritants are not irrational or exceptional? What if they are everyday recurring phenomena which imply – perish the thought – that the world is not a rational order driven by a set of universal rules, iron laws or systemic logic? The sceptics, of course, will ask mockingly, if international political and economic affairs are truly idiosyncratic and arbitrary, how is it possible to explain the stability, continuity, recurrence and regularities that are so manifestly obvious in the world order? To ask this question, however, is to make an important error. A non-rationalist ontology (what exists) and epistemology (theory of knowledge) need not automatically privilege the *irrational* – and all its quirky outcomes – but rather a different *kind* of ‘rationality’; almost certainly one that is non-universalist and not based on pure reason. It would explain order – and disorder – as the product of institutional and historical continuity, formal and informal rules of conduct, social and institutional interaction, common pathologies, consciousness and language, conflict and contest, and so on. Post-rationalism, then, divorces the concept of actor-rationality (which is understood as the subjective rationalization of preferences and goals) from historical behaviour. In other words, real or imagined, actor’s rationality does not translate into rationality in history. Post-rationalist narration of order and change tends to stress, therefore, the contingent and non-rational dimension of human history.

Such a ‘post-rationalist’ sensibility has long existed in the social sciences. There are a great number of contributing traditions. They include, to name a few, hermeneutics, CRITICAL THEORY, discourse analysis, constructivism,

deconstruction, POST-STRUCTURALISM, POST-MODERNISM, and institutional and evolutionary economics. With clear differences between them, they draw on a critique of rationalist political economy based on common philosophical foundations shared by the Marxism of MARX (the Marx that Deleuze and Guattari, for instance, have uncovered), the institutionalism of VEBLEN and Commons, the hermeneutics of Heidegger and Gadamer, the post-structuralism of Foucault and Lyotard, and the psychoanalysis of Freud and Lacan. This said, however, there is no clear line separating rationalist from post-rationalist thought. The two sets of traditions have crossed paths on many occasions in the past to produce a variety of hybrids. US pragmatism, for instance, pioneered by John Dewey early in the twentieth century, is credited by some as the forerunner of modern RATIONAL CHOICE theory, but owes much to hermeneutics (Mirowski, 1990). Similarly, modern rational choice theory seems to be spilling into post-rationalist economic thought (Wilkinson, 1997).

Post-rationalist thought, which now poses a paradigm-shifting threat to the rationalist orthodoxy in the social sciences, has been surprisingly silent in IPE and largely confined to recent attempts to forge a constructivist IPE (Jørgensen, 1998; Adler, 1997). This entry summarizes the differences between the two traditions, then goes on to articulate a post-rationalist IPE. The term ‘post-rationalist’ is used loosely in order to gather together a variety of strands which reject pure rationalist thought but also recognize the possibility of logical inference in certain circumstances. (The prefix ‘post-’ is intended to convey this loose linkage with rationalism.) This entry, finally, illustrates the difference that such a perspective makes by contrasting its probable analyses of the links between MNCs and states with those offered by rationalist IPE.

Rationalism and ‘post-rationalism’

Rationalism, in the narrow sense, refers to the view of history as a secular phenomenon in which reason rather than faith becomes the

guiding principle (the 'enlightenment' or 'modern project'). The rationalist account of human history stresses ideas of progress, self-understanding and continuity, centred on the principle of logical organization.

Rationalism has come to be associated, however, more specifically with two additional assumptions. First, epistemologically, rationalism belongs to the traditions of thought that maintain that there is or there can be a universally valid theory of knowledge. Rationalism aims therefore at a universally valid science, whose purpose is to fix the formulations of the human sciences. Disparagingly, the crowning achievement of rationalist thinking would be 'an automaton to which all disputes would be submitted and hence would guarantee the validity of scientific work' (Mirowski, 1990: 85). More neutrally, the definition offered by the *Encyclopædia Britannica* (vol. 15: 527) is:

Rationalism is the philosophical view that regards reason as the chief source and test of knowledge. Holding that reality itself has an inherently logical structure, the Rationalist asserts that a class of truths exists that the intellect can grasp directly. There are, according to the Rationalists, certain rational principles ... that are so fundamental that to deny them is to fall into contradiction. The Rationalists' confidence in reason and proof tends, therefore, to detract from other ways of knowing.

In short, 'common to all forms of speculative Rationalism is the belief that the world is a rationally ordered whole, the parts of which are linked by logical necessity and the structure of which is therefore intelligible' (ibid.: 528).

Consequently, second, modern rationalist thought pays particular attention to methodological questions and to the perfection of logic-based techniques of social investigation such as rational choice, GAME THEORY, statistical methods and, of course, logical abstraction based on rational insight (as distinct from sense experience or intuition). Rationalism is a doctrine that is grounded on the assumption that the subject (be it the individual, social

classes, states or society in general) has consistent sets of objectives and preferences, and they act instrumentally to achieve desired ends. As such, they are logically decipherable through *a priori* thinking and testable techniques.

A counter-position is that there is no general law, logical coherence and holistic integrity to be found 'out there' – or 'in here' in the mind. Mind and reality or observer and observed are not separated, 'truths' are time- and space-specific, reason, beliefs and experiential practices intermingle, and wholes are leaky or internally inconsistent. Powerfully, an evolutionary or historical perspective would assert that what appears to us 'natural' or given is nothing but a product of a specific historical and spatial context. Veblen (1994 [1889]), for instance, argued that social institutions such as the family, private property or sovereignty have evolved over a long time and became associated in our minds with human nature. They are social institutions (not universal laws or abstractions) that are historically and socially constituted and, though slow to change, the bearers of different imprints and meanings in different contexts. Thus, against the universal validity and logical rules of rationalism, we have the situated, socially constructed and evolving institutional trajectories of historicized thought: an '*histoire raisonnée*' (Schumpeter, 1950) in which history itself, not logic, constitutes theory.

One origin of anti-rationalist thought lies in the critique of a secular and liberal conception of the subject as rational actor. In particular, the objection was against the view of humans as the subject of egotistical desires and rational calculations, for which nature and society provided merely the means of fulfilment. If we are to look for forerunners to the important epistemological shift away from universal ego that occurred at the end of the eighteenth century, the philosophical grounding comes from Kant's notion of the *a priori* and the idea that we cannot know things-in-themselves. Kant demonstrated that fundamental concepts such as space and time, mass and force, and so on, are free fictions which 'cognition devised

... in order to dominate the world of sensory experience' (Cassirer, 1955: 85). From this point, it was only a small step to argue that:

sign is no mere accidental cloak to the idea, but its necessary and essential organ ... Consequently, all truly strict and exact thought is sustained by the symbolic and semiotics on which it is based.

(ibid.: 86)

From this kind of reasoning, we can derive five central tenets of post-rationalist thought:

- 1 *Truth is intra-subjective*: In a radicalization of Kant's idea, Fichte maintained that truth is intra-subjective. Before Kant, theory held that mind conforms to objects. Kant held, however, that object or knowledge conforms to the mind's own intrinsic operation (the *a priori* postulates). Fichte went further, proposing that the ego was a wholly creative principle of the world and consequently 'mind is not limited by some circumscribed sphere of real objects of experience but rather by its conception of its own activity' (Ermarth, 1978: 44). It follows that knowledge and truth-systems are purely intra-subjective: they relate to the realm of mind and not some objective pre-theoretical world. Post-rationalism evolves from a critique of what Hegel called the 'static truth' of the Cartesian tradition, seeking its replacement with the notion of 'discursive truth'. In Hegel's words:

all that I can express by language is a universal; even if I say 'this thing here' I am still expressing it by an abstraction, and I cannot attain the 'thing-itself' in speaking of it. Through the 'miracle' of the understanding, with its power of abstraction, it is the negation of the thing itself which provides it with a universal essence in the concept. And since the named thing is still a universal, so too, is the *ich*.

(Cited in Wilden, 1968: 194)

Thus, truth is not universal but temporal and discursive; it is a matter of communica-

tion. This lies at the heart of the linguistic turn in post-rationalist thought: to stress the salience of language and communication as the filter and substance of meaning.

- 2 *Truth as interpretation*: Previous cultures, as well as ours, are founded on their own unique understandings of logic and truth. They therefore require interpretation, or a hermeneutic understanding, to unravel the meaning of their system of beliefs, structures and institutions. 'We are what we make of ourselves in the course of our activities', thus there:

can be no exit from this all-pervasive shared background of understanding to gain access to brute facts or neutral data that which might ground our interpretations.

(Guignon, 1997: 174)

Both researcher and participant are caught in this interpretative trap and capable of only contingent truths. Foucault casts doubts on the concept of an objective agency prior to human reflection, such as an 'individual' or 'social classes'. Neither subject, nor the preferences of rationalist thought, are 'pre-theoretical' or given.

- 3 *Truth as power*: Since truth is temporal, discursive and contingent, truth-systems are viewed not as reaching out to some transcendental, universally valid categories, but as systems of power grounded in particular sets of social relations and knowledge systems. Just as we have discovered that other civilizations' myths, science, theories and religions do not serve pure and simple neutral functions, but serve to rationalize the social order, so post-rationalist thought suspects that our modern sciences and myths play a similar role. Knowledge and the method of acquiring knowledge is therefore not separated from the study of society. Foucault went further and demonstrated that the rationalist assumption that knowledge serves power is itself predicated on an objective conception of knowledge. He took the view that knowledge is not external to power, but knowledge *is* power. Knowledge is a way of 'ordering and organization of a

world constituted by our experience' (Glaserfeld, 1984: 24) which, at the same time, is a way of constructing the world. The concept of power (as expressed by Foucault) is expanded beyond an understanding of power as domination or capability, to one of power as a constitutive dimension of social life, insofar as it is imbricated in and expressed through knowledge.

- 4 *Truth as classification*: Mirowski (1990) calls this the Durkheim–Mauss–Douglas thesis. Attendant to the theory that knowledge is power is the thesis that, in all primitive cultures, the classification of things reproduces the classifications of humanity. Equally, the social classification of humanity is often a mirror image of a culture's classification of the natural world. Consequently,

the logical patterning in which social relations are ordered affords a bias in the classification of nature, and that in this bias is to be found the confident intuition of self-evident truth. And here, in this intuition, is the most hidden and most inaccessible implicit assumption on which all other knowledge is grounded. It is the ultimate instrument of domination. (Douglas, 1975: 209)

Thus, it is the categories that we create which frame truth, rather than any intrinsic logical order or rationality 'out there' and 'in here'.

- 5 *Truth as institutionalized action*: If there is no universally rational agent or structure (that is, no rationalist truths), how are truths defined as shared understandings formed in time and space? Institutionalists and behaviourists stress the role of rule-following (Vanberg, 1993) – rationalities rooted in collective institutions such as laws, habits, conventions, norms. These are rules of habit, bounded and procedural, as well as deliberative and experiential, that frame action and garner common understandings. Thus, 'institutions consist of informal constraints and formal rules, and of their enforcement characteristics. Together they provide the rules of the game of human interaction' (North, 1993: 245). More specifically,

institutions and routines – which we more broadly call *rules* – perform this function in economic evolution: rules are 'reproduced' and economic actors imitate or borrow knowledge from others. Institutions are, after all, shared knowledge ready and waiting for individuals to adopt.

(Langlois and Everett, 1994: 12; original emphasis)

Institutions are the social genes of replication and imitation, but also selection, variety and evolution. Here, *homo sociologicus*, guided by adaptive learning through trial and error and reflections on the past (not *homo oeconomicus*, guided by adaptation through rational foresight), evolves in a path-dependent but also unpredictable way. There is no teleological order or perfect endpoint, but multiple 'truth experiments' with varying outcomes.

These five tenets are the basis of the post-rationalist contention that social research is philosophically and methodologically different from the methods of the exact, rationalist sciences. Social scientific research must develop methodologies that do not rely on false observer/observed schemes or on the empiricist distinction between truth/fact and thought/illusion.

Post-rationalist IPE

Post-rationalism draws on a venerable tradition that reaches all the way back to Kant and Hegel. But, to be considered a viable alternative in IPE, it needs to be able in a reasonably satisfactory way to (1) define itself in relation to other IPE traditions, (2) provide an alternative explanation of the events and history of the international political economy, and (3) provide a basis for alternative practices that can be credited to post-rationalist thought.

What should a post-rationalist IPE look like and where should we draw its disciplinary boundaries? This is not an easy question, partly because of the difficulty in finding a

disciplinary home. Post-rationalist thought is profoundly transdisciplinary, not only because of its generalized applicability, but also because of its broad institutional reach. For example, as Wilkinson notes,

economic activity is socially constructed and maintained and historically determined by individual and collective actions expressed through organizations and institutions. The analysis of economic actors therefore becomes a collective endeavour of economics, sociology, history, organization theory and political philosophy.

(Wilkinson, 1997: 309)

It follows that post-rationalist thought does not acknowledge any fundamental distinction between political economy and other social science disciplines – they are in fact indistinguishable, or they should be indistinguishable. This is no trivial observation: as political economy has tended to stress, at one level this involves the inseparability or mutual influence of the economic (resource mobilization and wealth-creation) and the political (authority, power and control) and at another level the possibility of logically deducing the core rational principles of social organization and evolution. Post-rationalism suggests a new political economy that is as sensitive to culture and society in explaining economy and polity (for example, the values of elites or consumer preferences) as it is to the epistemological and ontological tenets summarized above.

But why discuss the nature of political economy if the topic of discussion is IPE? Principally because, for many theorists and practitioners of IPE, the latter is the study of IR – usually inter-state differences or the global order – through the lens of political economy. Political economy today, as distinct from economics defined as a science or box of tools concerned ‘with the attainment and with the use of the material requisites of well-being’ (Marshall, 1961 [1890]: 119), is closer to classical eighteenth- and nineteenth-century formulations as a science of economic organization, though with continuing connotations of

management, regulation and even orderly natural laws (Groenewegen, 1994).

The ‘international’ in IPE is simply the object of study, to be explained through political economy – Marxist (with its emphasis on systemic laws binding economy, civil society and polity) or other (more narrowly economic and individual-centred) versions. The ‘international’ is reduced to a stage or field of organization, viewed along two extreme lines. One line maintains that the entire international arena constitutes one (capitalist) system and it is the system’s dynamics that determine questions of order and change, distributing this or that function or outcome to individual nations and regions. The other tends to conceive the inter-national in a comparative sense as a series of social formations, each subject to asocial rules of economic and political conduct. Here, the relation between the national and the international is viewed along the notion of a ‘mode of insertion’ (Mistral, 1986) or ‘two-level game’ (Putnam, 1988).

With the emphasis on the words ‘political’ ‘economy’, a post-rationalist IPE – having problematized fundamental categories, such as politics and economics or state and market – could be described ambitiously as a meta-discipline that not only rejects the traditional boundaries in the social sciences, but also the traditional boundaries between the social sciences and humanities. At different times, different disciplines have vied for this dubious privilege – anthropology, sociology, psychoanalysis, political economy and now perhaps IPE. The late SUSAN STRANGE, a leading protagonist, would have tended to agree, describing IPE as:

a framework of analysis, a method of diagnosis of the human condition as it is, or as it was, affected by economic, political and social circumstances.

(Strange, 1988: 16)

But to stop here seems unsatisfactory, not only for the practical reason that the study of IPE risks becoming a nightmare for students daunted by having to read across the disciplines, but also because IPE risks losing any

specialized insight or unique set of concerns. Post-rationalist IPE too can continue unperturbed, without interrogating its specificity. As a subdiscipline, IPE has focused on international or transnational state relations (diplomacy, state practices, power, authority and control) from the perspective of political economy (for example, capitalist driving forces or power of particular economic institutions); it has theorized the state in a certain way. Like political economy, it has locked itself into the assumption of fit or complementarity between political authority and market forces, even when explaining discontinuity and change. For example, the Marxist stress is placed on the 'internal contradictions of capitalism' as the ultimate cause of change in the global political economy, while those studying dominant institutions might place the emphasis on the changing nature and function of the multinational enterprises (MNEs) and/or technological regime.

The economic and the political, together with the national and the international, are seen in terms of order and fit. The international system and economy and polity are seen to be in equilibrium, or temporarily out of it, while a new order settles. The dynamic through which order and disorder are actively constructed, or the possibility of explaining dynamic change and evolution in terms of the lack of fit between the political and economic and/or states and markets, are ruled out. A post-rationalist IPE, however, with its emphasis on interpretation, intra-subjective identities, variety, institutional action and non-linear evolution, rules them in.

Thus, while we may acknowledge Strange's meta-disciplinary aspiration, if we were to insist on a specialization for IPE, then we would argue that while rationalist IPE is grounded in a unitary theory of the state, post-rationalist IPE shifts the terrain by offering a theory of states or a theory of the plurality of states. This changes the order of question from how order and change come about in a 'social formation' or 'world system' to how order and change are constructed in a system of fragmented political authority. More

specifically still, we would define as its central task – because of the glaring omission in traditional IPE – the need to theorize the transnational system within a framework of fragmented political authority. Thus, if the coherence and fit within the world system or a social formation are assumed to not hold, how is the global political economy (now understood as a criss-cross of institutional arrangements at varying scales of articulation) to be explained as a source of contextual difference and specificity, but also of common patterns and influences?

Post-rationalist IPE, currently at its modest beginnings, should not be expected to provide a fully theorized answer to this question. But the elements of an answer can be formulated, once the very fundamentals of human reason and knowledge are placed in a historical context and once the credibility of system- or actor-logic and coherence is punctured.

First, post-rationalism assumes that the system of states is itself historically situated and hence transitory. Not surprisingly, points of transition, break and transformation should attract the attention of post-rationalist IPE, leading to discussions of the complex forms of evolution and change in the changing nature of politics, state and forms of global governance (see GOVERNANCE, GLOBAL). It is therefore not surprising that, as scholars debate whether globalization signals the end of the era of the nation-state or perhaps even the withering of the state system itself, there is a growing interest in post-rationalist thought. For not only are the traditional actors of international affairs under dispute, but the rationality of action and the very nature of political action are not entirely clear. While rationalist thought tends to conceptualize change through unilinear, one-dimensional methodological lenses – from bipolar to multipolar balance of power, from one hegemon to the next, from state to a 'global state' – post-rationalist approaches are by their very nature more attentive to the practices, beliefs, discourses and contradictions of an evolving situation. There is no attempt to saddle the present or the future within existing theoretical frameworks.

Second, since all socioeconomic orders are products of human action and imagination, it follows that the present one too is a human product, despite all the systemic seductions of a new global order that appears to be a coalition of powerful states, institutions and firms. The pertinent question is: How has the social environment in which we find ourselves come about? In other words, how is the international 'structured' and, conversely, how does it change? And here constructivist thought is revealing, notably in its careful analyses of the language and discourses of international integration, which have served to establish a common set of understandings and, ultimately, frames for action (Haas, 1992; Adler, 1997). As Börzel puts it,

material factors, such as rational interest and power resources, are not able to account for important outcomes and developments in [international] politics. Social constructivists have forcefully established that 'fussy variables' (Risse), such as norms, ideas and identities, are crucial to analysing and explaining international relations.

(Börzel, 1998: 23)

Thus, for example, in the construction of the EUROPEAN COMMUNITY (EC) as a politico-economic sphere, purpose-built terms such as 'opt-outs', 'flexible integration', 'multi-speed Europe' and so on, have played an important role on establishing a new common economic and political field (Christiansen, 1998).

Third, by historicizing and contextualizing the international arena, the new IPE maintains a critical stance towards current forms of order, perceiving them as specific forms of power structures, forged consciously and unconsciously through settled knowledge, discursive and institutional routines and norms. In this way, post-rationalist IPE suggests implicitly that order is actively maintained, but is also fragile and open to all kinds of alternative outcomes of a path-dependent or revolutionary nature, owing to the contested and humanly shaped nature of any given 'settlement'.

On a more general note, post-rationalism tends to avoid debating abstractions (such as

globalization) and prefers to focus on specifics. There is a whole array of theoretically sophisticated empirical studies of various facets of globalization, from the changes to the state and politics, to the transformation of the multinational firm, to modern histories of subjectivity and the 'post-modern' condition.

Alternative interpretations and possibilities

On the basis of the new approach, how might some of the big 'themes' of IPE be addressed? While there can be no single post-rationalist interpretation of events, let us take the example of the relations between transnational corporations (TNCs) and the state to speculate on a likely story. The rationalist conception in IPE of this relationship is that of two sets of utility-maximizing actors interacting with each other. TNCs are profit-motivated actors, while states either advance their population's welfare or are power-seeking actors who exchange security and influence for taxation. POWER is viewed as mediating the outcome between these two sets of maximizing actors. And, now, often we hear that power has shifted from the state to TNCs or is shared in a cosy alliance between the two (more precisely TNCs and the most powerful states). This relationship, indeed, is cited as the perfect illustration of the logic of the international political economy – states and firms in a maximizing rational order.

A post-rationalist interpretation, however, may point us in a different direction. Institutionalists, for example, might argue that these two 'actors' are among several institutions of political-economic interest and force, and therefore jostling for position, but in odd ways (see INSTITUTIONALISM). There is a certain division of labour between the two, but they are also in conflict, each drawing on an armoury of tools – material, discursive and symbolic – to gain influence. As such, outcomes are not predictable, but negotiated and contested, with each actor-network perpetually frightened of loss of status. Now, states and TNCs appear no less powerful, but no longer are they instrumentalist maximizing institutions, but complex

organizations that exceed their goals and functions, but in non-utilitarian ways. Their language, their scripts, their histories, their techno-structures and artefacts matter; analysis of these reveals them to be trapped in their own evolutionary logic, but also constantly at work to renew themselves. From such a perspective, both states and TNCs lose their identities as rational subjects. As Marcus remarks on the 'diffusion of the culturally sensitive corporate form':

values, norms, collective ethos, authority in personal relations, and participatory structures of groups now seem to be a salient and very serious frame of thinking for corporate managers at all levels. What was once primarily the intellectual capital of oppositional groups or critics of corporations now seems to be appropriated by corporate leadership as an integral yet ambivalent characteristic of their own thinking.

(Marcus, 1998: 5)

Without doubt, much of this cultural turn is for purposes of legitimization, internal and external, but it is also becoming a normal state of affairs. Such developments also affect the state, with all the burgeoning concern with transparency, democratic accountability and so on. The changing pattern of politics and state, together with the changing corporation, can be viewed as part of an increasingly reflexive order. Both state and TNCs are deeply involved in a 'language of adaptation' – in which they represent themselves to themselves and others – as actors seeking to adapt to (and shape) a supposedly changing world 'out there' that brooks no delay or complacency. Marcus, recalling Schumpeter, writes:

The value of flexibility and a vision of continuous change embedded in newer conceptions of culture provide the necessary doctrines for corporations in uncertain times. The double-edged quality of the term *creative destruction* itself captures well the ideological and cognitive work that cultural discourse currently does for corporations: *creative* counterbalances and gives positive

value to a process that is undeniably *destruction* with considerable human costs and displacements implied.

(ibid.: 10; original emphasis)

States are devising complex and varied strategies of competition (Palan and Abbott, 1996), while the TNCs seek to 'cope with complexity' (Thrift, 1998). But of course there is no 'out there' separating the observer from the observed. We know full well, in post-rationalist IPE, that 'out there' is structured to no lesser extent by states and TNCs. The discourse of adaptation and creative destruction then becomes an instrument of change, in which the varied 'strategies of competition' mobilized by competitive states, regional agencies and other public actors, and the 'coping strategies' of firms, have the effect of producing forms of governance and authority which in fact shape the world. In this way, what is taken as 'negotiated outcome' and the product of power play has to be recognized as the symptom of deeper forces at play that define the changing nature of the field.

Such a perspective suggests that what we see in the new repertoire of state and TNC strategies is not a simple shift in the balance of power from state to TNCs or a new global corporatist alliance, but a process in which the existing institutional structures adapt and change to both accommodate and sustain capitalist accumulation in new forms. States are not separate from, or antagonist to, TNCs but, with them, part of a deeper shift towards new institutional forms (for example, the 'cultural corporation'), producing different blends of capitalism in different geo-temporal contexts. By focusing on evolutionary and discursive processes, the alternative approach moves us beyond the state versus market debate, to allow a proper analysis of the changing nature of markets and states. Yes, perhaps TNCs and states are still the forcing houses, the proscribing institutions, but now we can see what new order or disorder they proscribe. Now we can, for instance, seriously investigate the implications of TNC 'coping strategies' that force an extension of horizons,

so that the TNC becomes at once an all-embracing institution taking in production, employment, consumption and culture, and a Goliath terrified of being slain by uncontrollable histories.

An alternative, post-rationalist, IPE implies alternative practical and political outcomes. The rationalist approach elides cause with effect, not least because outcomes are seen to be the product of rational behaviour or system logic. Thus change is explained in terms of either the breakdown of rationality or the birth of a new rational order. Actors and the mess of history appear largely as bystanders in the great battles of logical action. To return to the example of state–TNC relations, typically the global economy is seen as a ‘powerful states–big capital’ drama, out of which the only escape is a titanic clash between the dominant players, unstoppable internal contradictions or system failure.

A post-rationalist perspective, in contrast, is likely to focus on the constructed nature of power, the underbelly of the dominant elites and variety of outcome. It will stress different forms of TNC–state relations, with more or less benign outcomes in different social and cultural settings, depending on the balance of power and interest between the two players and the strength of local civil society. It will focus on the complex ways in which power is precariously maintained and on the irritants, oppositional forces and fears which constantly challenge. It will point to how all sorts of alternatives – such as small-firm networks, informal and third-sector activities, economic arrangements based on (say) Islamic or Buddhist principles – continue to prosper, and not just in the interstitial spaces beyond capture by the transnational elite. In short, it will demythologize power and rational order and, in so doing, open up scope for seeing the world as a diverse and contested place, without a teleological purpose.

This is not to claim, to be clear, that there is no rational order or that anything is possible. This would contradict the settled patterns of behaviour and evolution that we observe in world affairs. Instead, it is to claim that there

are multiple (ir)rationalities at work, that these (ir)rationalities are not given and that (dis)-order is the product of overlapping and opposed actor-worlds. It is to claim – without diminishing the extraordinary power of global capitalism and major players – a place for everyday variety and the possibility of non-linear, perhaps also counter-hegemonic, change.

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POST-SRAFFIAN THEORY *see* neo-Ricardian (post-Sraffian) theory

post-structuralism

Post-structuralism in international political economy (IPE) emerges at the forefront of three issues: culture, power and history. In terms of culture, what post-structuralism tries to achieve is a respect for the real and material existence of people. This in itself invokes the question of POWER – both how power operates in society and everyday situations, and how it functions historically to inform the parameters of experience and behaviour. These parameters are seen as historically specific – unique to given apparatuses of knowledge and control. This concern for the interdependence of knowledge and power (or 'power/knowledge') is not simply reducible to familiar notions such

poverty

as 'identity interests' or 'cultural hegemony'. What is at stake is not the specific ways of doing things (denoted in French by *connaissance*) or the ebb and flow of ideology, but the schema within which actions become imaginable and find a coherence (*savoir*). These underlying knowledges form a matrix, or historical grid, within which a culture defines its relationship to the most basic and vital elements of its social existence (for example, its relationship to discipline, to production, to security, to health and so on).

For the progenitors of IPE, the main knowledge in contention was that of economy and capital relations. For post-structuralists, however, what lies behind the birth of capitalism (and ultimately the global political economy) is a more immanent question of *order* – of how societies are established and governed. Thus, like the Gramscians, post-structuralists are concerned with the question of social power. Yet, unlike the Gramscians, the question of hegemony is not one of moral leadership or ideological consciousness, but the degree of efficiency with which bodies are organized, deployed and made productive. More than this, post-structuralists are concerned to reveal the ways in which subjects are encouraged, via the mobilization of particular discourses of truth, to constitute themselves as objects of knowledge, self-management and modification. Thus, unlike the Marxists, realists and liberals (see LIBERALISM; MARXISM–LENINISM; REALISM), power for post-structuralists is not simply the ability to say 'no'. Rather, power is also the capacity to engender, to produce and to optimize forces. Though similar in some ways to Susan Strange's concept of STRUCTURAL POWER, post-structuralists further deny that power has any structure, indeed that it has any essence at all. Rather, power is seen as invested within given practices and domains of knowledge (for example, colonialism, political economy, theories of globalization and so on). Power is, at most, a temporary illusion: the overall effect of a multiplicity of forces traversing bodies and societies. It is not acquired, seized or ever possessed. It is deeply contingent on the

present – an insight that reopens questions of culture, history and politics. Through detailed study (sometimes called 'archaeology' or 'genealogy'), post-structuralists aim to confront so-called 'structures', highlighting the fragility of things and their openness to possible transformation.

See also:

Gramsci, Antonio; modernity; world order

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POST-WASHINGTON CONSENSUS *see* Washington consensus

poverty

Traditionally, 'poverty' has been defined in terms of shortfalls of CONSUMPTION or income. Nowadays the concept of poverty also includes such dimensions as the ability to lead a long, creative and healthy life, to acquire knowledge, to have freedom, dignity, self-respect and respect for others, and to have access to the resources necessary for a decent standard of living.

Introduction

While living standards have risen dramatically over the last decades, including in the developing world, poverty is rising rapidly in Europe and Central Asia, and continues to rise slowly in Latin America and SUB-SAHARAN AFRICA. Only in South Asia, where most of the world's poor still live, has the proportion of poverty significantly declined over the last two decades. However, the financial crises of the late 1990s in the region have led to this progress slowing down and will probably even indicate an increase of poverty.

Concepts of poverty

Poverty is an extreme form of UNDERDEVELOPMENT. As such, it is not surprising that many poverty indicators are the same as those used to measure DEVELOPMENT.

Still the most common way to measure poverty is based on incomes or consumption levels. People are considered poor if their consumption or income level falls below some minimum level necessary to meet basic needs. This minimum level is usually called the 'poverty line'. What is necessary to satisfy basic needs varies across time and societies. Therefore poverty lines vary in time and place, and each country uses lines that are appropriate to its level of development, social norms and values.

When estimating poverty worldwide, the same reference line has to be used and expressed in a common unit across countries. The most widely used reference lines are those set by the WORLD BANK at US\$1 and US\$2 per day in terms of 1985 purchasing power. At the beginning of the 1990s, around 1.3 billion people worldwide had consumption levels below US\$1 a day (which equals almost 30 per cent of the total population of the developing world) and almost 3 billion people worldwide lived on less than US\$2 a day.

In 1990, a new way of measuring development and (indirectly) poverty was introduced by the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP). They created an index,

combining life expectancy, educational attainment and income into a composite Human Development Index (the HDI). The concept of poverty was thus directly related to human development. If human development is about enlarging choices, poverty means that the opportunities and choices most basic to human development are denied: to lead a long, healthy, creative life and to enjoy freedom, dignity, a decent standard of living, self-respect and the respect of others. So poverty, from a human development perspective, implies more than the lack of what is necessary for material well-being. In order to measure poverty in this broader sense, and to compare poverty over time and between countries, UNDP presented in 1997 the Human Poverty Index (HPI). The indicators of the HPI are related to life expectancy and adult illiteracy, but also to access to health services and safe water, and child malnourishment.

Other dimensions of poverty

Poverty thus has many dimensions. It can be approached from either subjective (utility) and/or objective (welfare) perspectives. Most conventional poverty measures are of the objective type, like poverty lines and basic needs. Only recently has the international community taken more interest in the subjective perspective. Subjective poverty, or the degree to which a person or group actually considers themselves poor or deprived, can sometimes be misleading. For example, persons without the means or capacity for meeting their basic needs may, in fact, not consider themselves to be poor. This kind of drawback partially explains the conventional emphasis on objective indicators of poverty, which also have the advantage of lending themselves to comparability across time, groups and regions.

Poverty can also be viewed in relative and absolute terms. Relative poverty is usually held to mean being poor, in some respect or other, in relation to some other individual, group or society as opposed to non-relative measures of poverty. For example, households incapable of obtaining sufficient food for survival are

power

considered absolutely poor. However, such a household need not necessarily be poor in relative terms: the costs and composition of their food basket could be higher compared to those of other groups, regions or countries. Even within so-called 'absolute' poverty, countries often distinguish between indigence or primary poverty and secondary poverty. Indigence usually refers to those who do not have access to the basic necessities for human survival, while other forms of absolute poverty refer to degrees of deprivation above that threshold.

Poverty may be chronic (long term) or temporary (short term). Chronic poverty is usually the most difficult to address, since it is associated with a complex set of interconnected and often mutually reinforcing causal factors. These might include reduced social spending and reduced subsidies on primary necessities due to economic reform policies; a lack of social solidarity due to ethnic problems and/or political instability; the presence of natural environmental factors, such as soil erosion and structural drought; and a lack of development opportunities in general.

Temporary poverty may be the result of a one-off decline in living standards from which a household gradually emerges, or fluctuations in well-being may result in numerous declines in living standards already below the poverty line. For example, external shocks in the form of policy changes or natural disasters may cause a household to plummet into poverty. Seasonal variations in food security may also result in some households periodically falling in and out of poverty over time.

Reducing poverty

After being partly neglected in the last two decades, poverty alleviation is again high on the international agenda. In general terms, one can distinguish three important issues that deserve particular attention:

- 1 According to neo-classical economists (but not only them), accelerated economic growth is the most powerful weapon in the

fight for higher living standards (see NEO-CLASSICAL ECONOMICS). The TRICKLE-DOWN effect of economic growth is seen here as the crux to reducing poverty.

- 2 Improving the distribution of income and wealth is another challenge. The benefits of economic growth for the poor may be eroded if the distribution of income worsens. Particularly in Latin America, poverty is rising because of increased income inequality. If, for example, Latin America had the relatively equal distribution of income that is seen in Asia, income poverty would have almost vanished in the region.
- 3 Accelerated social development by means of direct intervention is also considered an important prerequisite to decreasing poverty. Female education, safe water and sanitation, child immunization, as well as social safety nets to protect the most vulnerable, remain indispensable in the future for both the developing and the developed world.

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power

Power, traditionally understood as resources or 'capabilities', has been used as an indicator for the capacity to affect or control events. Likewise, a general capacity to control outcomes has been used as an indicator for the ruling of the international system. In other words, the

concept of power has been of central importance in international theory, because it seemed essential for the understanding of two central issues: (1) who (one or more actors) can be expected to win a conflict? and, related to this, (2) who (one or more actors) governs international politics?

The resurgence of power analysis in the last twenty years, mainly in international political economy (IPE) and constructivist international relations (IR), challenges these tacitly assumed links. Criticizing the 'lump' concept of power typical of REALISM, neo-institutionalism has tried to redefine the link between resources and outcomes. Similarly, with regard to the understanding of 'rule' and 'governance', different STRUCTURAL POWER approaches have shown the need to make concepts of power more encompassing in order to capture important facets of international rule.

Critique of the 'lump' concept of power

All realist theory relies on the concept of the balance of power, which presupposes a common denominator for power. This central assumption has been challenged by early realist critiques and more recent institutionalist approaches.

In an argument that represents an anticipatory blow to the economic analogy in NEO-REALISM, Raymond Aron (1962: 97, 102) opposed this aggregated concept of power. Such a concept of power assumes an analogy with money in economic theory. For such an analogy to work, power needs to be as 'fungible' as money. The term 'fungibility' refers to the transferable or convertible character of goods which allows their substitution. Indeed, with the advent of money as a general standard of value within which competing preferences can be put on the same scale, compared and traded-off, economists were able to reduce the variety of preferences to one utility function. In world politics, however, because of its lack of real-world fungibility, power cannot play a corresponding role as a standard of value. With no power-money analogy, there is also no analogy between the

integrated value of utility and the 'national interest' (security). Hence, even apparently ultimate power resources like weapons of mass destruction might not be of great help in getting another state to change its monetary policies (Baldwin, 1989: 25, 34, 209).

As David Baldwin had already showed a long time ago, a single international power structure relies either on the assumption of a single dominant issue-area or on a high fungibility of power resources. Since both are of little avail, it

is time to recognize that the notion of a single overall international power structure unrelated to any particular issue-area is based on a concept of power that is virtually meaningless.

(ibid.: 167)

Power in IPE: Neo-institutionalist link between resources and outcomes

In the 1970s, power analysts had to cope with the 'paradox of unrealized power' – exemplified by the US defeat in Vietnam. Although popular, the explanation of a 'conversion failure' had to be discarded since it saved the importance of power simply by making theories unfalsifiable: Vietnam did not reveal the relative weakness of the United States, but only its unrealized strength. Neo-institutionalist analysis offered a more sophisticated answer.

One conceptual way out consisted in accepting the apparent lesson of the Vietnam War. Consequently, control over resources (even issue-area specific ones) does not necessarily translate into control over outcomes. Power no longer functions as a determining cause. In applying REGIME THEORY, ROBERT KEOHANE (for instance) increasingly came to doubt the causal role of power. While discussing HEGEMONIC STABILITY THEORY, he showed the empirical anomalies of the 'crude' version, which derives the existence of regimes solely from shifts in the distribution of power. A more sophisticated version needs to rely on an aspect of the unit level, namely leadership. This aspect moves the analysis away from hegemony as a

component of a scientific generalization where power is a necessary and sufficient condition for cooperation (Keohane, 1984: 39). In Keohane's model, the determination in the explanation shifts from interests defined in terms of the distribution of power, to RATIONAL CHOICE made on the basis of given interests defined in terms of 'power, expectations, values and conventions' (ibid.: 75). This solution comes at a price, however: only predictions of a very limited kind are possible and with a secondary role for power. Power is assumed to be one of the two primary motivations for rational action (see RATIONALITY). Similarly, the distribution of power is part of the actor's definition of the interests of an actor. Hence, power no longer serves as the main determinant of outcomes.

Another solution, most forcefully proposed by David Baldwin, consists in keeping a strong causal role for power by further specifying the relational and situational context that defines those policy instruments that can count as actual power-resources in the first place. The stress on the relational context is only a logical consequence of Baldwin's insistence that power is not in resources, but in human relations. It is a relational, not a property concept. If people who want to commit suicide are threatened with a gun and ordered to choose between their money and death, they might not feel threatened at all. The gun-bearer has no power over the suicidal person in this regard. In other words, power comes not (only) out of the utility attached to resources, but exists through the actual value systems of human beings in their relations with each other. Consequently, the researcher has first to analyse the value systems of the interacting parties, in order to establish whether there are power-resources in the first place.

For this reason, Baldwin (1985: 285; 1989: 134) insists that one can only study power, if understood as a causal variable, in well circumscribed 'policy-contingency frameworks'. The context then specifies the scope and domain of power, as well as the norms and values within which interaction takes place.

Once circumscribed, power can be defined as a causal antecedent to an outcome.

Keohane, by keeping contextual analysis to a fairly general level, can make probabilistic predictions on behavioural outputs, but not outcomes, leaving power as a secondary variable. Baldwin's attempt to keep power as a central causal determinant forces him to include all the necessary information in a contextual analysis, thereby making clear predictions on the basis of power impossible.

Rule in IPE: structural power and governance

With the link between resources and control weakened, the second link (between the distribution of control over outcomes as indicators of international rule) might not be worth studying at all. Yet this is where IPE has made its most important contribution to international power analysis. In fact, concepts of structural power redefine the context within which strategic interaction takes place, the resources considered important for assessing capabilities in the first place and the outcomes that should be included in power analysis. Their common claim is that the *sole* reference to the first link (as is done by neo-institutionalists) is insufficient for, if not biased against, achieving an understanding of rule in the international system.

A first version of structural power could be called *indirect institutional power*. This refers to the 'ability to manipulate the choices, capabilities, alliance opportunities and pay-offs that actors may utilize' (Caporaso, 1978: 4). Here, structural power refers to the conscious manipulation of the institutional setting within which bargaining relations take place. Many important issues are decided before they reach the bargaining stage – indeed, often because they never reach it. Similar conceptualizations can be found in the notions of 'structural power' developed by SUSAN STRANGE (1988) and of 'meta-power' developed by Stephen Krasner (1985). Despite occasional claims to the contrary, these versions of power are all perfectly

compatible with neo-institutionalist approaches.

Structural power has also been conceptualized as *non-intentional power*. Strange (1988) suggested we should think of power backwards from its effects and not in terms of intended outcomes. Her concept of structural power stresses both the diffusion of the origins of power (and the variety of power resources) and the diffusion of its effects. For her, power no longer lies mainly with states or with military capabilities, but with (for instance) the international control of credit and knowledge. Similarly, there is no reason to exclude from power analysis all those crucial effects that might not have been intended. Whether interest-rate policies of the German Bundesbank were intended to destabilize the EUROPEAN MONETARY SYSTEM (EMS) is less significant than the fact that only a few players could have effected such an outcome. This analytical shift from intentions to effects diminishes the importance of the neo-institutionalist approach of attempting to understand power based on resources, interests and rationality. It focuses on systematic, not chosen, features of power. Such an approach is compatible with an individualist approach, yet not with a behaviouralist one (Guzzini, 1993: 456–61).

Structural power can also be understood as *systematic bias* or *impersonal power*. In the words of James Caporaso, this refers to the 'social structuring of agendas [that] might systematically favor certain parties' (Caporaso, 1978: 33). Such an understanding of power was common currency in DEPENDENCY THEORY writings, both Marxist and non-Marxist. They are still used in IPE in the Gramscian School (Gill and Law, 1988). This form of impersonal power cannot be accounted for in individualist approaches, which would criticize the attempt to deduce power from benefits. Instead, it would conceptualize it as 'systematic luck' (Dowding, 1996: chap. 4).

Such a conceptualization of systematic bias as mere luck, however, might unduly restrict the analysis of power phenomena. For the wording is not innocent. Concepts of power fulfil different purposes (Morris, 1987: 37–42)

To mention two, power is (1) used in practical contexts where we are interested in what we can do to others and what others can do to us, and (2) important in moral/legal contexts where it functions as an indicator of liability or responsibility – if actors could not have done an act (if they lacked the capacity to do so), they cannot be found guilty of it. The first concept indicates the realm of action: power as an indicator of politics, politics as the 'art of the possible'. The second concept assesses possible blame. By calling systematic bias 'luck' rather than power, conceptual analysis precludes this phenomenon from being considered a political item, putting or defining it out of reach of the 'art of the possible'.

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STEFANO GUZZINI

Prebisch, Raul (1901–86)

Raul Prebisch was one of the founders of development economics. He became Professor of Political Economy at the School of Economics of the University of Buenos Aires in 1925 and held a number of posts in the Argentine government during the 1930s, including Under-Secretary of Finance (1930–2) and Director General of the Central Bank (1935–43). He then moved to the United Nations (UN) where he was Executive Secretary of the UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA (ECLA) (1948–62), the Director General of the Latin American Institute for Economic and Social Planning (1962–4) and the first Secretary General of the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) from 1964 to 1969. With the return of democracy in Argentina in 1984, he became a personal adviser to President Alfonsín and he remained closely connected with ECLA until his death.

As an economist, Prebisch was influenced by the experience of the GREAT DEPRESSION and his reading of *The General Theory* of JOHN MAYNARD KEYNES in the 1930s. He played a major part in the development of the Latin American structuralist approach to development, which emerged from ECLA, and the formulation of an alternative economic paradigm to that of NEO-CLASSICAL ECONOMICS.

A key premise of the approach which Prebisch adopted was the significance of structural differences between the advanced capitalist economies of the centre and the underdeveloped economies of the periphery (see CORE–PERIPHERY MODEL). First, the advanced economies were internally homogenous with similar levels of productivity in different sectors and regions, whereas those of the periphery were characterized by heterogeneity

as a result of the coexistence of sectors with widely differing levels of technology and productivity. Second, the advanced economies were diversified, whereas those of the periphery were specialized in a relatively limited range of activities, particularly in the primary sector (agriculture and mining).

Prebisch used these insights to analyse a number of economic problems that faced the countries of Latin America. He is best known (along with HANS SINGER, another UN economist) for his theory of the secular deterioration of the TERMS OF TRADE of underdeveloped countries (see PREBISCH–SINGER HYPOTHESIS). While conventional economics predicted that the terms of trade would tend over time to move in favour of primary producers and against producers of manufactured goods, because of the tendency for DIMINISHING RETURNS in primary production, Prebisch observed that the terms of trade of Latin America had historically deteriorated since the late nineteenth century. He explained this paradox in terms of the differences in demand and supply conditions affecting the production of primary products and manufactured goods.

This analysis provided a rationale for the advocacy of IMPORT SUBSTITUTION in Latin America, in order to reduce dependence on the export of primary commodities. Prebisch also pointed to the advantages of developing exports of manufactured goods, but this was not acted upon. Subsequently, with Prebisch at the helm, UNCTAD took up the problems of primary commodity prices, particularly with the advocacy of the INTEGRATED PROGRAMME FOR COMMODITIES (IPC). Indeed, Prebisch's ideas lay behind many of the demands which were incorporated into the call for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) in the 1970s.

Although his name will always be associated with terms of trade, Prebisch also addressed a number of other key development problems in his writings. He pointed to the persistent tendency towards external deficits in developing economies and contributed to the debate between monetarists and structuralists over the causes of inflation in Latin America. He also

highlighted the problem of structural unemployment associated with the import of capital-intensive technology from the advanced industrial countries.

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RHYS JENKINS

Prebisch–Singer hypothesis

According to the Prebisch–Singer hypothesis, which was launched simultaneously by HANS SINGER (1950) and RAUL PREBISCH (1950), the net barter TERMS OF TRADE between primary products and manufactured goods (seen as a measure of the real price of primary commodities or, alternatively, as the terms of trade between DEVELOPING COUNTRIES and developed countries) had been, and could be

expected to continue to be, subject to a downward long-run trend. This analysis directly contradicted the then prevailing orthodoxy, which saw an increase in the price of primary products relative to manufactured goods as an inevitable consequence of the twin forces of (1) diminishing returns in the production of primary commodities from a fixed stock of land (including mineral resources) as population increased and (2) downward pressure on production costs in manufacturing, generated by the moderating influences of surplus population and urbanization on wages.

The hypothesis has spawned a vast literature concerning both its theoretical underpinning and its empirical validity. The explanations that can be found in the literature for the observed downward trend may be summarized as:

- 1 Differing elasticities of demand for primary commodities and manufactured goods (with the inelastic nature of the former resulting in a tendency for increases in the conditions of commodity supply to be felt more strongly in price decreases than in quantity increases).
- 2 Differing rates of growth in the demand for primary commodities versus manufactured goods (with the demand for primaries expanding less rapidly than the demand for manufactures due to their lower INCOME ELASTICITY OF DEMAND – especially so in the case of agricultural commodities due to the operation of ENGEL'S LAW – plus the development of synthetic substitutes and the occurrence in manufacturing of technical progress of the sort that saves on raw-material inputs).
- 3 Technological superiority (the argument being that the prices of manufactured goods rise relative to those of primaries because they embody both a so-called 'Schumpeterian rent' element for innovation, plus an element of monopolistic profit arising from the monopoly power of multinational producers).
- 4 Asymmetries in market structure (the argument here is that differences in market

pre-emptive investment

structure – with primary commodities typically being produced and sold under competitive conditions, while manufacturing in industrialized countries is often characterized by a high degree of monopoly by organized labour and monopoly producers – mean that while technical progress in the production of primary commodities results in lower prices, technical progress in manufacturing leads to increased factor incomes, as opposed to lower prices).

The hypothesis is sometimes advanced as an argument in favour of development policies of the IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) (as opposed to EXPORT PROMOTION) varieties. However, the policy issues here are not clear-cut and, as pointed out by Singer (1987), the fact that all four of the above explanations relate as much, if not more, to the characteristics of different types of countries as distinct from different types of traded goods, highlights the need to devise and implement policies that address differences and imbalances of the former, as opposed to the latter, sort. Given the challenge that the Prebisch–Singer hypothesis laid down for the then prevailing orthodoxy, it attracted criticism from a number of quarters. The ensuing debate, which initially focused its attack on the basis of issues related to the treatment of transport costs and quality change, is well summarized by Spraos (1980), who showed that adjustments for shipping costs and changing quality left the hypotheses largely undented, in the sense that they failed to destroy its empirical validity. However, since the mid-1980s, the debate surrounding the Prebisch–Singer hypothesis shifted to the statistical arena. Detailed reviews of the recent statistical evidence are presented by Sapsford and Balasubramanyam (1994) and Sapsford and Chen (1998), who conclude that, although initially launched more than half a century ago, the Prebisch–Singer declining long-run trend hypothesis has stood the test of time remarkably well. This longevity is all the more remarkable when one recognizes the wide array of statistical techniques to which the hypothesis has been sub-

jected. There can be few hypotheses in economics that have stood the tests of both time and new statistical techniques so well.

See also:

commodity agreements; enclaves; United Nations Conference on Trade and Development (UNCTAD)

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DAVID SAPSFORD

pre-emptive investment

'Pre-emptive investment' describes the investment decisions of one firm (in new plant and equipment or in taking over another firm) when they are made with regard to the actions, actual and potential, of rival firms (for

example, under conditions of OLIGOPOLY and INTERDEPENDENCE between the rivals).

A substantial investment in a protected foreign market of rather limited size may discourage rival multinational enterprises (MNEs) from entering, since they anticipate there will be over-capacity and little or no profits. Investment in a promising area for oil discoveries could not only add to the firm's reserves, but deny rivals an important opportunity; the rapid spread of McDonald's outlets in a developing country might succeed in occupying many good locations that are then unavailable to rivals; buying up firms that are being privatized in Eastern Europe or Latin America capitalizes on a unique entry opportunity; early entry into China – a 'big market of the future' – may enable a firm to gain influential local allies, with good political contacts that are in scarce supply. In all these cases, the investing firm 'pre-empts' actions/opportunities of other firms, gains 'first-mover advantages' and may acquire MARKET POWER.

Such investments may be central to a firm's strategy for achieving growth and above-normal profits or 'economic rents'. Investment in research and development (R&D) can also have a pre-emptive character in the race to develop new products and help set new international technical standards. In its REGULATION of competition, the STATE needs to monitor investments which may inhibit competition; however, one state or group of states may wish to support 'home' firms in making pre-emptive investments in high-technology, capital-intensive industries in line with STRATEGIC TRADE THEORY. The fear of rivals making pre-emptive investments can lead to a rush of investments in a promising market, resulting in excess capacity.

See also:

product-cycle model

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DAVID LAW

PREFERENTIAL TRADE AGREEMENT (PTA) *see* trade blocs

price elasticity

'Price elasticity' measures the responsiveness of the quantity of a product demanded to changes in market price. However, there are different price elasticity concepts: price elasticity of demand, cross price elasticity of demand and price elasticity of supply.

If price elasticity of demand is symbolized by ϵ_d , it can simply be defined as:

$$\epsilon_d = \frac{\text{percentage change in quantity demanded}}{\text{percentage change in price}}$$

Normally, the quantity demanded decreases if the price rises, implying a negative price elasticity of demand. If $\epsilon_d = -2$, an increase in price of 1 per cent leads to a fall in quantity demanded of 2 per cent. However, usual practice is to ignore the negative sign and speak of price elasticity of demand as a positive number.

Demand is said to be *inelastic* if the price elasticity is less than 1 and *elastic* if price elasticity is greater than 1. The most important determinant of elasticity of demand is the availability of substitutes. A product with close substitutes, such as butter (with margarine as substitute), tends to be elastic. A product without close substitutes, such as alcohol, tends to be inelastic. An extreme case is a perfectly inelastic good: elasticity of demand is zero. The quantity demanded does not respond to any price change – consumers buy a fixed quantity regardless of the price. Another extreme case is a perfectly elastic good: elasticity of demand is infinite. Consumers are not willing to pay more than a fixed price, but

primitive accumulation

are willing to purchase unlimited quantities at this price.

Cross price elasticity of demand of good x with respect to the price of good y is symbolized by ϵ_{xy} and defined as:

$$\epsilon_{xy} = \frac{\text{percentage change in quantity demanded of good } x}{\text{percentage change in price of good } y}$$

The cross elasticity of demand with regard to the price of a *substitute* is positive. For example, when the price of butter increases, the quantity of margarine demanded also increases. The cross elasticity of demand with respect to the price of a *complement* is negative. For example, when the price of cars increases, the quantity of gasoline demanded decreases. If the cross elasticity of demand for gasoline with regard to the price of cars amounts to -2 , the quantity of gasoline demanded will decrease by 2 per cent if the price of cars increases by 1 per cent.

The price elasticity of supply is the analogue on the supply side to the elasticity of demand. If it is symbolized by ϵ_s , it can be defined as:

$$\epsilon_s = \frac{\text{percentage change in quantity supplied}}{\text{percentage change in price}}$$

Supply elasticity is said to be *inelastic* when it is less than 1 and *elastic* when it is greater than 1. An important determinant of elasticity of supply is the ease of substitution in production. Supply tends to be more elastic the easier it is to shift from the production of one product to another whose price has increased. Length of time is also important for response. Supply tends to be more elastic in the LONG RUN than in the SHORT RUN.

M. PETER VAN DER HOEK

PRIMARY MARKET *see* markets, primary

primitive accumulation

KARL MARX was concerned to show that the capitalist MODE OF PRODUCTION was historically specific and rooted in the emergence of specific class relations. He satirized those economists who argued that the origins of CAPITALISM were rooted in abstinence on the part of a section of the population, who supposedly chose to productively invest rather than consume. Marx pointed out that this approach assumed precisely what is supposed to be demonstrated, namely the existence of capitalist RELATIONS OF PRODUCTION. It was therefore guilty of naturalizing and dehistoricizing capitalism: an example of COMMODITY FETISHISM. For Marx, then, the *quantitative* accumulation of capital had its roots in *qualitative* social change, in which the feudal mode of production was replaced by the capitalist mode. This was the real basis for the so-called 'primitive accumulation' of capital.

In *Capital*, Marx examined the process of primitive accumulation in Britain. The origins of capitalism are to be found in the dispossession of the peasantry, who are barred from direct access to the means of production. Such dispossession was especially marked from the eighteenth century through state legislation enclosing demesnes and vacant peasant plots. ENCLOSURES had the effect of increasing the number of landless labourers – which in turn provided capitalist tenant farmers with a labour force who had to earn a wage in order to live – and of (gradually) generalizing commodity production. Thus the primitive accumulation of capital 'is nothing else than the historical process of divorcing the producer from the means of production' (Marx, 1976 [1867]: 885).

Some writers, associated with neo-Marxist DEPENDENCY THEORY, have argued that this approach does not account for the role of international trade and, in particular, the part played by COLONIALISM and slavery in the process of primitive accumulation. Marx was, in fact, acutely aware of these factors:

The discovery of gold and silver in America, the extirpation, enslavement and entombment in mines of the indigenous population of that continent, the beginnings of the conquest and plunder of India, and the conversion of Africa into a preserve for the commercial hunting of blackskins, are all things which characterise the dawn of the era of capitalist production. These idyllic proceedings are the chief moments of primitive accumulation.

(ibid.: 915)

Although these factors were morally reprehensible and devastating for various populations of what came to be known as the **THIRD WORLD**, the question of the relationship to capitalist development is more complex than a simple zero-sum game by which the European 'core' developed at the expense of the so-called 'periphery' (see **CORE-PERIPHERY MODEL**). First, if capitalism is defined as an expansion of trading relations, then we arrive back at the problems of its origins in abstinence. What accounted for the initial impulse to expand and why did it happen in Europe rather than the periphery? Moreover, why did the Iberian peninsula, major players in the New World, fail to develop along similar lines to Britain? The most convincing answer is still that in Britain capitalist relations of production had emerged and so there was a compulsion to reinvest that did not exist in feudal Spain and Portugal. Second, the evidence concerning a substantial transfer of surplus from periphery to core is unconvincing. Trade between core and periphery was on a small-scale from 1450-1750 and there was no large-scale increase at the height of Britain's **INDUSTRIAL REVOLUTION**. The plunder of the periphery may have contributed to the primitive accumulation of capital, but it hardly caused it. Once again then, quantitative factors were important, but had their basis in the qualitative transformation of the social relations of production in Britain.

Marxists have continued to address the question of the relevance or otherwise of the 'British model'. **KARL KAUTSKY** and **LENIN**,

for example, examined the specific form of transition to capitalism in Germany and Russia. Briefly, Lenin identified a Prussian road, which involved the formation of a capitalist class out of the existing class of feudal landowners, and a US path, in which independent family farmers became differentiated over time and thus became capitalists or proletarians. Informative and sometimes brilliant work continues in this field, with particular emphasis placed on the differing and uneven transitions from non-capitalist to capitalist modes of production in the Third World. Of particular interest has been the agrarian question, by which productivity in agriculture can be increased in order to feed the peasantry and supply a surplus for industrial development. Preobrazhensky also applied the concept of primitive accumulation to socialist Russia in the 1920s in an attempt to formulate a strategy by which a surplus could be extracted to support socialist industrialization. The concept can also be utilized, albeit in a setting in which the producers are already deprived of direct access to the means of production, in assessing the transition from **STATE SOCIALISM** to capitalism in Eastern Europe.

See also:

class formation; neo-Marxism; underdevelopment thesis; world-systems theory

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principal financial centres (PFCs)

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RAY KIELY

principal financial centres (PFCs)

Principal financial centres, or PFCs, are cities in which major levels of international financial activity occur. Their significance is derived from a concentration of expertise and decision-making capacity which exerts an overwhelming influence on the global financial system. This influence is supported by the broader confluence of economic, cultural and social power within a relatively well-defined urban area, and is clearly associated with the exercise of international political power. The international significance of PFCs lies in the way in which together they constitute a transnational dimension within the global economy, alongside the more traditional dimension of national economies. Clear examples of PFCs in the twentieth century include London, New York and perhaps Tokyo.

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RANDALL D. GERMAIN

prisoners' dilemma

Prisoners' dilemma is a model from GAME THEORY that has found wide use in international political economy (IPE). It illustrates how individual incentives can undermine mutually beneficial cooperation. As such, the game of prisoners' dilemma has close ties to the problems of COLLECTIVE ACTION, COLLECTIVE GOODS, EXTERNALITIES, the FREE RIDER

PROBLEM, OPTIMAL TARIFFS, RECIPROCITY and the TRAGEDY OF THE COMMONS. Nevertheless, there are important limitations on its applicability to problems in IPE.

The game of prisoners' dilemma

Figure 9 gives prisoners' dilemma. Each of the two players simultaneously chooses whether to cooperate or defect. The table specifies how the players rank the four possible combinations of choices, where the letters represent numbers such that $T > R > P > S$. If both players cooperate, they both receive the Reward payoff, R. If one cooperates while the other defects, the defector receives its best outcome (Temptation, T) while the cooperator receives the Sucker payoff, S. If both players defect, they both receive the Punishment outcome, P.

In prisoners' dilemma, both players are better off playing Defect, regardless of what the other player does: if the other player cooperates, the Temptation payoff is greater than the Reward payoff, and so defection is better than cooperation; if the other player defects, the Punishment payoff is better than the Sucker payoff. However, the consequence

of these individually rational choices is bad for both players. Both players receive the Punishment outcome when they both defect. Both would be better off if they both cooperate: they would each receive the Reward outcome. They would like to make an agreement to cooperate. However, that agreement is not enforceable because both will play Defect, breaking the agreement. This is the dilemma.

The dilemma can be alleviated if the game is played repeatedly without a definite endpoint. The players can use the threat of defecting in a later play of the game to enforce an agreement to cooperate in the current round of play. If both players place a high enough value on future plays of the game, the loss from a future defection can be greater than the gain from defection in the current play. Consequently, it will be in the interest of both players to honour their agreement to cooperate. The reciprocal threat can be sufficient to deter defection from the agreement.

Many different reciprocal strategies can be used to enforce cooperation in repeated prisoners' dilemma. Best-known is the TIT-FOR-TAT STRATEGY, which plays Cooperate in the first play and then matches the other player's prior

		Player 2	
		Cooperate	Defect
Player 1	Cooperate	(R, R)	(S, T)
	Defect	(T, S)	(P, P)

Figure 9 The game of prisoners' dilemma

prisoners' dilemma

move in all later plays of the game. However, many other reciprocal strategies can also enforce cooperation. These strategies differ in the precise reciprocal punishment employed. For example, the 'grim trigger strategy' will play Defect for all future plays if the other player defects once. If the reciprocal punishment is sufficient to deter defection, then punishment is never observed and these reciprocal strategies produce the same behaviour.

Cooperation is easier to support through reciprocal punishments as (1) the actors' influence on the future increases, (2) the short-run gain from defection decreases, (3) the punishment gets more painful and (4) the reward for cooperation increases.

It is common to assume that $2R > T + S$. This assumption ensures that an agreement to cooperate every round is better than an agreement to allow a player to defect in one play and the other to defect in the next play.

A system of reciprocal punishments requires the ability to determine what the players have done in the past. Otherwise, the harmed parties do not know whom to punish. This issue of monitoring looms larger as the number of players increases. We can consider games with more than two players, where each player has the same choices and motivations as in the prisoners' dilemma. Monitoring could also be an issue if factors outside the control of the players affect the outcome. The players could mistake bad outcomes caused by such factors for each other's purposeful defection. Reciprocal punishments could then lead to retaliatory feuds and the breakdown of cooperation. Monitoring problems change which reciprocal strategies enforce cooperation most effectively. These general reciprocal strategies are more forgiving of small defections and more vengeful against large defections.

Connections to other issues

The problem of controlling tariffs illustrates well the application of prisoners' dilemma to IPE. Consider a pair of states that trade. Each has an optimal tariff which maximizes its share of the benefits of the trade. However, overall

trade is reduced if both adopt their optimal tariff. Both are better off if they reduce their tariffs below their optimal tariffs. Defection corresponds to adopting an optimal tariff and cooperation to adopting a lower tariff.

Reciprocity is the solution suggested by repeated prisoners' dilemma. In the short run, both states prefer adopting an optimal tariff. Both can be discouraged from doing so if they agree that the adoption of an optimal tariff will be met by the imposition of **COUNTERVAILING DUTIES**. The long-run loss of trade is large enough to outweigh the short-run incentive to adopt an optimal tariff.

Other problems in IPE also resemble the prisoners' dilemma. The provision of **PUBLIC GOODS** creates incentives by which all actors prefer that others bear the cost of the public good. If all follow their individual incentives, then the public good will not be provided and all are worse off than if the public good is provided with the cost shared equally among all. Like the prisoners' dilemma, individual incentives undermine common interests.

Actors may be able to provide public goods through reciprocity, analogously to the repeated prisoners' dilemma. Such efforts require the ability to determine each actor's record of contribution – which corresponds to cooperation in repeated prisoners' dilemma. This monitoring of behaviour and sharing of the results across all is more likely in small groups than large ones. Enforcement is easier if the group can withhold the benefits of the public good from defectors selectively. Otherwise, reciprocal threats require suspending the public good, hurting both cooperators and defectors. Both of these conditions, small groups and benefits which can be suspended for individuals, are more likely for international public goods than others. For example, access to the global trading system has both these characteristics.

Nevertheless, the provision of public goods is not identical to the prisoners' dilemma. Cooperation in the prisoners' dilemma requires both players; individual actors may be capable of providing public goods alone. The provision of public goods then may be easier than the prisoners' dilemma analogy suggests. Specific

issues have particular characteristics that limit the applicability of a simple, general model like the prisoners' dilemma.

Limitations of prisoners' dilemma as a model

Although prisoners' dilemma is a compelling model of some problems, there are important limitations to its applicability:

- 1 There is no guarantee that the players will agree to cooperate in repeated prisoners' dilemma. Agreements to cooperate can be enforced, but that result does not imply that the players must reach such a cooperative agreement.
- 2 A range of cooperative agreements can be enforced through reciprocal threats. For example, the players could agree to alternate cooperation and defection from play to play. The model does not predict which agreement the players will reach.
- 3 Repeated prisoners' dilemma may not be a useful model of issues in international security. The possibility that states can eliminate one another can undermine the reciprocal threats that support cooperation.
- 4 Repeated prisoners' dilemma directs our attention away from questions of distribution in cooperative agreements in favour of enforcement concerns. The game is symmetric: both players have the same values for the outcomes. An agreement to play Cooperate every round provides both players with the same reward. However, there are often many ways to cooperate and the parties disagree about which way to cooperate is the most attractive. An agreement to cooperate then requires a choice of how they will distribute the gains from cooperation. Such distributional conflict could prevent the parties from reaching an agreement that was mutually beneficial and enforceable.
- 5 Repeated prisoners' dilemma focuses on specific reciprocity at the expense of diffuse reciprocity. Specific reciprocity occurs when the punishment is directly linked to earlier acts; diffuse reciprocity ties the promise of

future cooperation to good behaviour, without specific triggers or size of punishment. The reciprocal strategies that are commonly studied with repeated prisoners' dilemma are specific. In more general versions of repeated prisoners' dilemma, diffuse reciprocal strategies (such as those where my behaviour towards you is conditioned on your behaviour to others) can be modelled.

- 6 Not all situations where actors have an incentive to defect are prisoners' dilemma. The appropriate game to model a social situation depends on the choices of the actors, how their choices produce outcomes and how they evaluate those outcomes. Many problems in IPE resemble the prisoners' dilemma game. However, often there are critical differences that make a simple application of the lessons of the prisoners' dilemma misleading.

See also:

paradox(es) of rationality

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JAMES D. MORROW

privatization

The term 'privatization' describes the process of rendering private or bringing into the private

privatization

sector the production of goods and services previously owned and delivered by the STATE. By changing the balance between the public and private sectors in favour of the latter, privatization has reversed the trend of increasing state ownership and control in most developed economies. It has been used as a means 'to subject the public sector to pressures and practices to as great an extent as possible' (King, 1987: 123).

Privatization was initially associated with the politicians of the New Right, but subsequently has been pragmatically embraced by governments of both the Left and the Right in many other parts of the world, not least Western, Central and Eastern Europe. The United Kingdom was the first country to implement a major privatization programme. Ironically, despite privatization's subsequent close association with the governments of Margaret Thatcher (which pioneered the large-scale sale of public assets to the private sector during the 1980s), its political and economic significance was a relatively late discovery. The term 'privatization' did not feature in the Conservative Party's 1979 General Election manifesto. It was only when the first Thatcher government discovered the popularity of selling off state assets at a huge discount to the general public that it stumbled across the means by which elections could be won and the broader political agenda of the New Right advanced.

Economically, privatization was a policy which promised in the short term to simultaneously increase state revenue, reduce state borrowing and expenditure, and improve national economic performance. Ideologically, privatization could reduce the size and scope of the state and restore power to the individual, diminish the power of the trade unions, and help to create the ideal of a property-owning, share-owning, popular capitalism. Politically, privatization could help win elections by fostering the 'feel-good factor' in the electorate and force political opponents on the Left to rethink their policies (Whitfield, 1992).

Privatization has been implemented in a number of ways. It has involved the sale of state assets; the delivery by the private sector of

goods and services previously produced by the public sector; private control and management of state-owned assets and services; the reduction of state control over the development of industries and services through DEREGULATION and LIBERALIZATION; the provision of private capital to finance infrastructure and the replacement of grants by loans; and the commercialization of the remaining public services by modelling their organization and delivery on private firms or creating internal markets (Clarke and Pitelis, 1994).

The impact of privatization on economic performance has been mixed. Performance has tended to improve most markedly in those industries and services where competition has been introduced or extended. It has not reversed the relative economic decline of the United Kingdom, nor notably improved the performance of other economies which have undertaken privatization programmes (Bishop, Kay and Mayer, 1994). Where privatization has failed to create a competitive market structure, the state has assumed additional responsibilities for regulation and competition policy (Bishop, Kay and Mayer, 1995). The UK model of utility regulation has involved the creation of a series of independent regulatory offices with similar status and powers to the government departments they have been designed to replace. These offices have used price-based formulas, tied to the retail prices index and a calculation of likely efficiency savings, as the principal means for attempting to ensure that the privatized utilities do not exploit their monopoly market power.

Privatization has not depoliticized the regulation of these industries. Indeed, the UK experience points to the uncertainty and regulatory failures which can arise where a competitive market structure and specific regulatory rules have not been created prior to privatization. The privatized utilities are the only source of information about their operations. As private (often transnational) corporations, their resources are enormous compared to those of the regulators. Regulation has also created a potential conflict of interests between the shareholder, the consumer and the em-

ployee. Furthermore, in the United Kingdom there has been a marked increase in consumer dissatisfaction with the services provided by the privatized utilities, and major public disquiet about levels of profitability and executive pay – and the relationship between the regulators and the utilities (Ernst, 1994).

In some countries where privatization programmes have been implemented recently, it may be too early to make a definitive judgement about their impact on business efficiency, economic performance and social cohesion. However, in the polity where its implementation was pioneered more than a decade ago, privatization is widely regarded as having accentuated inequalities in income and welfare. Indeed, critics of the political economy of the New Right have associated privatization with an attack on the very cohesion of society, which now requires urgent and radical remedial action (Hutton, 1995). Therefore, the impact of privatization has tended to redefine, but not always necessarily reduce, the role of the state in politics, economy and society.

See also:

neo-liberalism

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SIMON LEE

product differentiation

Product differentiation means that the products belonging to a particular industry are less than perfect substitutes in consumption. Where the products of a particular industry are identical in the eyes of the consumer, they will be perfect substitutes for each other and therefore have a cross elasticity of demand equal to infinity. (A rise in the price of one good will result in an infinite increase in the demand for the other.) In some industries, product differentiation takes the form merely of differences in style or appearance and perhaps marginal performance (for example, soft drinks, different brands of cigarettes, different brands of breakfast cereals, soap detergents, ladies' fashion wear, men's shirts and so on). In other industries, product differentiation reflects differences in the performance capability of products (that is, quality differences in, for example, motor cars, personal computers, televisions and so on). Many industries exhibit both forms of differentiation.

See also:

intra-industry trade

NIGEL GRIMWADE

product-cycle model

The product-cycle model is a theory of international trade and production that was first developed in 1966, by Professor Raymond Vernon of Harvard University, to explain patterns of trade and investment in knowledge-intensive industries. Knowledge-intensive industries (such as the pharmaceuticals industry) are characterized by high rates of product innovation. This means that products have typically quite short market lives. Vernon suggested that products belonging to such industries enjoy a market life which can be split into three distinct stages, which he called 'novelty', 'maturity' and 'standardization'. The location of production and the pattern of trade changes as products pass through each of these stages.

New products are generally produced and exported first in high-wage economies (the United States in Vernon's model). The high cost of labour in these countries tends to create a greater incentive for producers to innovate. During the novelty phase, producers face little or no global competition. In their own home market and, perhaps, in other advanced industrialized countries, they are able to take out PATENTS which grant them the sole right to produce the good for a stated period of time (twenty years in the United States or Europe). This means that the relatively higher production costs prevailing in these countries can be readily passed on in price to the consumer. In short, the demand for the product is price inelastic. During this phase, the product is also likely to be subject to substantial modification, as producers receive feedback from the consumers regarding the desirability of the product.

Although most sales will initially take place in the innovating country, some output will soon be exported abroad to other countries where a market for the product exists. These will initially be other advanced industrialized countries where per capita income is high enough to create a market for the new product (Western Europe in Vernon's model). However, as the product reaches maturity, some overseas

production of the good will begin to take place. First, other producers will be able to buy the know-how through LICENSING agreements and indeed, as patents expire, they may be able to copy the innovation without infringing patent laws. Second, producers in the innovating country will invest in the creation of new overseas subsidiaries in order to be closer to the foreign market. In this way, they can reduce transport costs and overcome any TARIFF or NON-TARIFF BARRIERS (NTBs) which may be imposed on their exports. Overseas production then begins to displace exports as a means of servicing the foreign market. The existence of much greater competition during the maturity stage means that the demand curve facing producers is much flatter (that is, demand becomes more price elastic).

Finally, when products reach standardization, the existence of large number of producers results in intense competition. Such competition now takes the form, primarily, of price competition and causes producers to embark on a desperate search for ways to reduce production costs. This leads to producers setting up subsidiaries in low-wage developing countries and exporting the product back to the larger markets in the advanced industrialized countries. At this stage of a product's life, high-wage economies become net importers of the product and low-wage economies become net exporters.

Many examples of this kind of trade can be cited. Many consumer goods which were first discovered by producers in the United States or Europe are now produced mainly in low-wage economies (for example, portable televisions, video-cassette recorders, pocket calculators, cameras and so on). One of the most frequently cited examples is semi-conductors. Semi-conductors or transistors were invented in the United States, but gradually production shifted to Western Europe and Japan. Faced with increased competition from producers in other parts of the world, US producers invested in new lower-cost plants in the developing world. The South-East Asian economies, in particular, became important recipients of US FOREIGN DIRECT INVESTMENT (FDI). Subsequently, with

the development of the silicon chip, production shifted back to the United States. This triggered another cycle in which producers in Europe and Japan eventually acquired the latest technology. In an effort to cut costs, US memory-chip producers once again sought out new lower-cost locations abroad. Today, South Korea has become one of the world's main producers of so-called 'dynamic random access memory' chips (DRAMs).

See also:

knowledge industries; offshore production; technological change

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NIGEL GRIMWADE

production structure

The 'production structure' is identified by SUSAN STRANGE as society's arrangements to determine what is produced, by whom, for whom, by what method and on what terms. When a particular social group loses relative POWER, changes are likely to follow in who produces what and how such processes are organized. Additionally, when methods of production change there will probably follow a shift in the distribution of social and political power. The production structure impacts on the STATE through the relative power of the classes who are involved in production.

Therefore, STRUCTURAL POWER over production concerns the way that productive relations are arranged. The choices of what is produced, for what purpose and, importantly, what is not produced, take place within the production structure. Through the decisions over what is produced in any particular location – cash crops or high technology, cars or textiles – power in the production structure has a far-reaching impact on the international political economy and its UNEVEN DEVELOPMENT.

Strange broadly agrees with the structural basis of MARXIAN ECONOMICS, where the structure of productive relations is accorded a determining role, but she does not accept that it is the only structure: she considers it to be but one of four. Thus, for Strange, the struggle between classes influences change in the structures of power and the division between classes is tied up with the RELATIONS OF PRODUCTION, but changes in the international political economy are not determined by the production structure alone.

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CHRISTOPHER MAY

profit maximization

In the standard theory of the firm, the goal of profit maximization is central and is assumed to motivate firms' decisions.

In the simple theory, a firm produces an

propensity to import

output, thereby generating revenues and incurring costs, both of which increase as the level of output increases. The *cost* per unit of producing relatively few units will generally be high, particularly because of fixed costs such as office accommodation and basic amenities. As output increases, cost per unit is expected to decline, possibly to rise again at high output levels as increased costs (such as overtime payments) may be faced. *Revenue* per unit, on the other hand, may be assumed to be relatively high at low output levels and to decline to some extent thereafter, consistent with a downward sloping demand curve.

These trends suggest that at a particular level of output – the profit-maximizing level – *marginal* revenue (that is, the revenue from producing one extra unit) will equal *marginal* cost (the cost of producing the extra unit). Below this level, profits (defined as revenue minus cost) can be increased by increasing production, since the revenue from a further unit exceeds its cost of production. Above this level, the revenue from an extra unit is less than its production cost, so profits fall.

Profit maximization is not necessarily the only motivation of those who run companies. Where there is a separation of ownership and control (for example, between shareholders and managers), managers may think more in terms of total revenues and company size than profits, or be contentedly unconcerned if the company is generating ‘adequate’ rather than ‘maximum’ profits (the so-called ‘satisficing’ criterion). Even so, the assumption of profit maximization is often a useful starting point, sufficiently close to actual behaviour to yield useful results.

JOHN CLARK

propensity to import

A country's total expenditure on its imports tends to increase with its national income. This relationship is known as the ‘import demand function’. The average propensity to import is the ratio of imports to income and this varies

considerably between countries, with larger countries tending to have a smaller value than smaller countries. The marginal propensity to import is the change in imports that occurs consequent on a change in income. If the marginal exceeds the average propensity, a country's dependence on foreign trade will increase (that is, the average propensity will rise over time) and vice-versa.

J.S.L. McCOMBIE

property rights

Property rights are a theoretical framework used to analyse the economic, social and political actions of individuals and the development of corresponding institutional arrangements. The New Institutional Economics (or Property Rights) School of thought analyses how property rights are defined and enforced, how individuals respond to the incentives thus created, and how social institutions evolve in response.

Property rights are socially defined and enforced rights or powers to determine who, how and under what circumstances people may consume or use an asset, derive income or other benefits from it, alter an asset's form or substance, or transfer some or all of these rights to others through exchange. Ownership of an asset is equivalent to control of the bundle of property rights associated with that asset. **INTELLECTUAL PROPERTY RIGHTS (IPRs)** are the property rights associated with patents, copyrights and certain other intangible assets.

The fundamental assumption of the Property Rights School is that individuals act to maximize the value of their property rights subject to the existence of transactions' costs, which are the costs of thoroughly defining and fully enforcing property rights. If transactions costs are zero, then a system of private property and market exchange efficiently maximizes both individual and social value, which is Adam Smith's **INVISIBLE HAND** result. Individuals acting only to maximize the value

of their own property rights, unknowingly maximize social value too. Transactions costs are generally greater than zero, however, and therefore property rights are never thoroughly defined or fully enforced, and individuals and institutions must adapt to these conditions. Property rights research focuses on the implications of positive transactions costs for economic behaviour.

Economic EXTERNALITIES (such as air or water pollution) exist when transactions costs prevent one party from enforcing property rights with respect to the other party, leading to an external cost or benefit. Economic theory tends to treat such MARKET FAILURES as inefficiencies that may be corrected through government policies such as taxes or subsidies. The Property Rights School looks at externalities differently. The Coase Theorem (named after Ronald Coase, recipient of the 1991 Nobel Prize in Economic Science) holds that it is not as important to whom property rights are assigned in such cases as it is that they be thoroughly defined and assigned to someone, who then has an incentive to enforce them, eliminating or reducing the externality. Economic efficiency is maximized without recourse to government interference, according to property rights analysis, when property rights are defined and enforced so as to minimize the transactions costs associated with welfare-increasing exchange.

In some cases, property rights may be held communally or not defined at all. In such cases, it may be impossible to prevent anyone from benefiting from a scarce resource and the TRAGEDY OF THE COMMONS occurs. Individual incentives to gain from further use are inconsistent with a level that maximizes social value. The total value of the property rights declines as the resource is used beyond its optimal level.

MICHAEL VESETH

protection costs

'Protection costs' are the loss of potential or actual economic welfare as a result of policies, such as TARIFFS and QUOTAS, which are

designed to limit the benefits of international trade. While protectionist policies may benefit protected domestic industries, they also prevent competitive industries from maximizing their economic welfare by distorting domestic resource allocation. At the same time, domestic consumers suffer from the higher price of the protected goods. From the viewpoint of economic LIBERALISM, therefore, overall protection cost outweighs its benefits.

In practice, however, governments sometimes prefer to incur protection costs rather than to maximize economic welfare for political reasons. This is the case, in particular, when a government is confronted with well-organized business interest groups that demand protection of their industries. In the 1980s, the United States government forced Japanese automobile industries to abide by VOLUNTARY EXPORT RESTRAINTS (VERs) under pressure from the US automobile industry. However, many studies showed that these VERs increased consumer prices and even contributed to increasing Japanese automobile makers' profits.

See also:

non-tariff barriers (NTBs)

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YASUHIRO IZUMIKAWA

Proudhon, Pierre-Joseph (1809–65)

The first self-declared anarchist, Pierre-Joseph Proudhon proclaimed that 'to be governed is to

be watched over, directed, indoctrinated, controlled, robbed, repressed' (1989 [1851]: 294). His influence on nineteenth-century French SOCIALISM exceeded that of KARL MARX, and his plebian origins and experience in printing, journalism and business provided depth to his critical ideas which drew inspiration from the *philosophes* and the French Revolutionary legacy.

Proudhon's early writing offered a new political economy that condemned unearned capital. The pre-industrial, libertarian *What is Property?* (1994 [1840]) denounced private 'ownership' as theft, legally sanctioned by classical economists as rent and usury. His alternative was usufruct/use value – a non-coercive 'possession' of land and resources that a producer could neither sell nor inherit.

In the 1840s, Proudhon moved to Paris, joining proto-revolutionary exiles and the secret societies of the French Left. He relied on the normative LABOUR THEORY OF VALUE to measure the value of goods and services, and on the doctrine of SURPLUS VALUE, which he modified to include the workers' debt to past cooperative social traditions. Socioeconomic change derived from the mutualist fraternal associations which sprung up in Paris and Lyon: several hundred were formed after the 1848 revolution, with production and exchange controlled by sharing property and tasks without capitalist intrusion, allowing participatory investment decisions. This ideal of self-management was applied to small proprietors and newly developing industrial enterprises, relying on voluntary contractual agreements. After having been elected, Proudhon rejected parliamentarianism when he failed to win support for a progressive taxation bill.

Mutualism was nurtured by a People's Bank, formed in 1849. Lasting three months, it issued and accepted labour vouchers, providing interest-free credit. Interest rates, rents, dividends, wages and prices were to be reduced to re-embed the DIVISION OF LABOUR in equitable exchange. Proudhon's *Principle of Federation* (1979 [1863]) outlined a third way between a PLANNED ECONOMY and LAISSEZ-FAIRE. A decentralized, confederal polity that dispersed

power would combat chauvinistic NATIONALISM. The smallest provinces would have as much expression as the largest, balancing liberty and authority. The short-lived 1870 Paris Commune – massacred by the French army – operated on mechanisms of federalist anarchism.

Proudhon's moral impulse came from the Hebrew prophets and the tradition of civic virtue of Aristotle. Rousseau and Montesquieu, who criticized self-interested commercialism. Proudhon countered greed and corruption by reference to familial agency in refining motivations. His defence of self-government and criticism of Bonaparte III led to his imprisonment from 1848 to 1851. On release, he called for reconciliation with the bourgeoisie. Ten years later, after a working class revival (see CLASS, WORKING) and the consolidation of MONOPOLY CAPITALISM, Proudhon demanded an alliance with the middle class towards a non-violent direct action FEDERALISM against financial speculation.

Proudhon influenced French syndicalists, credit unionism and Greens in their stance against metropolitan centralism. Contemporary associationalists advocate the reinvestment of capital where it arises, regional taxation, devolution and a limited confederal state. A mutualist project backed by initiating governments could reduce the inadequacies of representative politics and the dominance of unaccountable financial institutions, as well as welfarist and corporatist BUREAUCRACY.

See also:

alienation; capitalism; coercion; exploitation; regionalism; self-help; stakeholder economy

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GEOFF ROBINSON

public choice (PC) theory

The fundamental orientation of public choice (PC) theory is deeply grounded in Machiavelian political theory: that is, how political leaders organize their interactions with individuals in civil society in order to gain and maintain power. Theoretically, the deep core of PC derives from work done by mathematicians of the eighteenth and nineteenth centuries (Laplace, Condorcet and Borda) on voting and from later work on social welfare economics (Arrow, 1951). PC is the study of politics using the tools of economic theory. It is revolutionary in that it breaks from the traditional study of politics in important ways. The traditional study of political phenomena lacked systematic assumptions about the motivations of individuals (both leaders and the governed) involved in political processes. PC imposed the standard assumptions of micro-economics onto actors in the political game. Both the public and leaders (politicians and bureaucrats) are analysed as rational, self-interested actors who through their interactions in the game of politics strive to maximize some objective function. This is functionally equivalent to the behaviour in economic markets, where individuals engage in transactions for the purpose of maximizing their utility as defined in terms of economic wealth. For PC, transactions take place in the 'political market', but unlike economic markets the currency of exchange is conceived of as political capital (resources which are essential to political processes). Like economic trade, actors in the political market engage in

voluntary transactions via political mediums of exchange (for example, policies for votes, legislative votes for campaign contributions). A decomposition of such political transactions essentially produces all of the conventional categories of the traditional micro-economic analysis of economic markets. There are well-defined supplies and demands for specific political outcomes. The outcomes themselves form equilibria which can then be evaluated in terms of standard efficiency criteria. Within such criteria, the structure of industrial organization in political markets and the robustness of market mechanisms (that is, perfect versus distorted markets) become fully operative in an analytical sense. In the case of the political marketplace, public servants fill the traditional micro-economic role of producers (firms), while individuals in CIVIL SOCIETY (acting either in groups or alone) are analysed as consumers.

Overall, actors in the political arena behave rationally in that they undertake actions according to well-defined cost and benefit schedules. Such is the case irrespective of whether they are undertaking political transactions or undertaking unilateral actions with political implications (for example, voting, reading about candidates in upcoming elections). The implications for the study of politics in this scenario are devastating for traditional political analysis: maximizing behaviour on the part of public servants means that policies are configured around collective social demand, rather than around what the public servants think is good for society. This being the case, PC theory is fundamentally grounded in the study of democracy, since only under such a form of government are political outcomes sensitive to societies' collective preferences. The PC study of autocratic government is far less developed. While the contributions which comprise PC are so vast as to make a simple summary description impossible, a representative overview of the deep core of PC theory can be obtained by illuminating principal issues and contributions in five categories: voting (social choice), demand, supply, institutions and normative PC.

Voting

Very early work done by Condorcet, Laplace, and Borda on voting behaviour set the groundwork for analysing how aggregations of individual decisions could manifest themselves as collective political choices. Spice was added to the study of voting when economists (Bergson, Samuelson, Arrow) opened the door to social welfare economics in the mid-twentieth century, principally through the seminal work of KENNETH ARROW (1951). Duncan Black (1958) synthesized previous analyses of voting into what many consider the major modern pioneering contribution in PC theory. The issue of aggregating individual preferences into some systematic benchmark of social utility took on enhanced significance with the revelation of Arrow's impossibility theorem. The theorem essentially showed that it is impossible to derive any adequate social utility function through the aggregation of individual preferences. Adequate in this sense meant that the social utility function was consistent with widely accepted axioms of collective choice. The major implication for voting, then, was the challenge of doing the impossible with the ballot: that is, constructing a voting procedure that could adequately maximize the collective will. One illustrative application of Arrow's impossibility theorem to the problem of voting deals with a phenomenon which has been referred to as 'the voting paradox' (also the 'Condorcet effect', 'Arrow problem' and 'cyclical voting'). Using the example of three voters with given preferences over three candidates, the construction of a stable collective preference ordering over the three candidates using a majority pairwise voting rule would produce an order which violated Arrow's transitivity axiom (that is, a consistent ordering of preferences over all alternatives). Let us say Voter 1 has an ordering $X > Y > Z$, Voter 2 prefers $Z > X > Y$ and Voter 3 prefers $Y > Z > X$. If a majority vote took place on each pair of alternatives, the resulting social ordering would produce a cycle: $X > Y > Z > X$ (that is, an unstable preference ordering).

In the same vein as economists considering ways of overcoming the impossibility theorem, PC scholars have wrestled with the idea of optimal voting procedures. This has led to a plethora of contributions on issues involving the consequences of voting rules. One representative example would be a comparison of a simple nominal voting rule (vote 'yes' or 'no' on alternatives), such as plurality vote, against a simple ordinal rule (takes into account the intensity of preferences over all alternatives), such as a Borda count (for example, assigning some scores to the rankings of alternatives and determining the winner based on an aggregation of these scores). Assume four voters with the following preferences over three alternatives: Voter 1 = $A > B > C$, Voter 2 = $C > B > A$, Voter 3 = $A > B > C$ and Voter 4 = $B > C > A$. In a simple plurality vote the winner would be A (with two votes, compared to one vote for B and C). But now let us assign some utility measure (utils) to the orders as follow: the top alternative is worth three utils, the second is worth two utils, while the last is worth one. Using a Borda count, the outcome would be different: B wins with nine utils, A would get eight utils, while C would get seven. The fundamental logic produces some compelling implications: procedures for actualizing collective decisions might produce outcomes that are contrary to what society really wants. In this case, the intensity of support for B dictated a choice that would have been impossible under a plurality vote. Since modern democracies predominantly employ nominal voting rules, one would expect that the outcomes of votes fall well below what might actually be efficient for those societies.

The cause for such concern runs deep, because collective decisions have been found to be extremely sensitive to the procedures instituted (that is, the consequences for efficiency in employing alternative voting rules are large). For example, voting outcomes have been found to be path dependent: alternatives are selected through a process extremely sensitive to the order in which they are considered. There are also interdependencies in choices such that the selection between any set of

alternatives will be influenced by the inclusion of alternatives outside that set (for example, the choice between A and B will be influenced by the inclusion of C). Because voting outcomes are so sensitive to the decision rules selected, much analysis in the PC literature has been directed towards the process of agenda construction and control.

Another major issue in the study of voting has to do with why individuals bother to inform themselves about upcoming elections and vote at all. Seminal work on the issues of rational ignorance and the paradox of voting was done by Anthony Downs (1957). Both voting and informing oneself about upcoming elections have posed challenges to the PC study of voting. Under the simplest rational calculation, individuals should neither become informed about elections nor vote. This calculation posits a choice between very small expected benefits from such actions and the real resources (mainly time) expended in carrying them out. Expected benefits are driven down by the extremely small probability that one's vote will actually be decisive in determining the winner in an election. While this may help explain a trend toward low turnout in large elections, it does not explain why so many people do vote. Contributions to the literature on voting have continued to explore different calculi (many of which include altruistic components) in trying to account for seeming paradoxes under simple decision rules like those posited by Downs.

Supply

On the supply side of the exchange relationship between public servants and civil society, PC theory has been concerned with the way in which policies are produced. One important issue under this rubric concerns optimal election platforms, and has become identified as the 'median voter problem'. Seminal work in this area was done by Hotelling (1929), who adapted theories of spatial competition among firms to two-party competition in representative democracy. The work was later extended by Downs (1957). The theory assumes that

voters could be distributed in terms of preferences on one issue: in the Hotelling–Downs logic, distribution occurred along a unidimensional liberal–conservative continuum. Under a simple majoritarian selection rule, candidates trying to win an election will configure their platforms on that issue in such a manner as to maximize the distribution of voters. Given such a set of circumstances, parties would naturally configure their stance on the liberal versus conservative issue around the preferences of the median voter, as such a point will guarantee a majority of the voter distribution. Put in terms of spatial competition among competing retailers, stores will be placed in the most convenient locations so as to minimize the distance customers have to travel. The work on median voter competition has proved quite valuable in accounting for important regularities in both campaigning and government financing. The theory accounts for tendencies toward under-differentiated platforms and policies that target middle-of-the-road voters. The imperative of capturing the median voter necessitates both, as appealing to the middle of the political spectrum will make platforms similar (the similarities being conditioned by policy preferences in the middle). In terms of financing, the theory explains a tendency for income redistribution in representative democracies to favour the middle class: that is, from the tails to the middle of the socioeconomic distribution in society (Director's law).

The study of the POLITICAL BUSINESS CYCLE suggests that such supply of government output could, when dealing with economic policies, produce a pattern of regular outcomes in the macro-economies of democracies. The simplest theory in this vein is based on seminal work by Nordhaus (1975). Where voters are myopic with respect to economic outcomes, politicians can maximize support by making short-run trade-offs on the Phillips Curve (inflating an economy shortly before elections and thus reducing unemployment, then using the safety of the post-election period to keep inflation in check). Given regular elections, this would produce a business cycle that is coterminous with the election cycle. Extensions of the

public choice (PC) theory

theory, as in Alesina *et al.* (1997), have explored the impact of rational expectations and party affiliation on political business cycles.

Just as candidates for political office compete through the shaping of prospective policies, local governments also engage in some kind of configuration of government output that has consequences for the supply of policy. PC theory has analysed competition between political districts in the provision of PUBLIC GOODS in just such a manner. Looking at districts as clubs, local governments produce some specific mixture of public goods (public services, infrastructures, school systems, recreational activities) so as to cater to optimal groups of like tastes. The process unfolds somewhat like product differentiation among firms which are engaging in market segmentation. Political markets (in the selection of districts) are fairly unencumbered as long as individuals can 'vote with their feet' (Tiebout, 1956). This makes the selection of a residence fairly amenable to micro-economic analysis, inasmuch as individuals choose some optimal basket of goods (in this case, policies and public goods) in accordance with their own reservation prices and opportunities elsewhere.

PC has also studied the supply of government output that is more autonomous: that is, output produced by bureaucrats who are not responding to some electoral imperative or group preferences. Even though bureaucrats are typically not elected officials, they are nonetheless public servants capable of shaping policies. While the electoral imperative does not drive their output, PC has studied their behaviour as a rational response to both their organizational priorities and personal preferences on what would benefit society. While traditional studies of bureaucracies have lacked systematic assumptions about the bureaucrats' motivations, PC characteristically analyses bureaucratic output as maximizing some objective function made up of a combination of personal, public and organizational goals. Work in this area by Niskanen (1971) has proved seminal.

Demand

On the other side of the micro-economic ledger, PC has studied the way in which societies bring their preferences for policy to bear on public servants. The problem of demand revelation has been systematically addressed within the study of voting with the ballot and voting with the feet. Individuals systematically express their preferences by selecting candidates for office or by moving to communities that offer policy mixes that accord with their specific interests. There are other means by which individuals in society express their interests on policy, and that is through mobilization. The issue of demand revelation through mobilization has led to a large number of studies under the rubric of RENT SEEKING, which is usually understood as the mobilization of small organized interest groups for the purpose of capturing some advantage for themselves through policy. The analysis is theoretically grounded in theories on monopolistic behaviour among firms. Groups, like firms, can enjoy advantages over competitors if they can secure some monopolistic position over outcomes in their domains. In the political game, this comes through policies which are biased in their favour. Hence, policy (like market control for a firm) is a desirable target for special interest groups. To attain this power, they bring resources to bear on influencing public servants to pass favourable legislation. A common example is the quest for a TARIFF. By taxing foreign goods, domestic producers can obtain a higher price for their product. This higher price comes from the restrictions placed on competition through the introduction of the tariff on imports (which makes demand for the product less elastic) and generates the opportunity to collect monopoly rents. Many contributions to this literature suggest that such rent-seeking behaviour generates greater inefficiencies than those represented by standard deadweight losses from monopoly, and may comprise additional wastes which are as large as the rents themselves.

The rent-seeking issue suggests asymmetries in demand revelation in democracies. Based on

the theory of COLLECTIVE ACTION (Olson, 1965), concentrated interests (small groups focused on a specific cause) can more effectively voice their preferences than larger, diffuse groups. The reason for this is that group size has an impact on the individual incentives facing members of those groups. Larger groups tend to face typically PRISONERS' DILEMMA payoffs (that is, individuals are discouraged from contributing irrespective of what others do). Such payoffs are less evident in smaller groups. This implies a fundamental law of PC: in a democracy, private-interest legislation will dominate public-interest legislation. For example, trade legislation shows a bias toward protectionism, thus reflecting the greater political voice of producers (who are concentrated) *vis-à-vis* consumers (who are numerous).

Institutions and normative PC

PC has used the tools of economics to explain the very political institutions that comprise the political marketplace. We can start with the origins of the state. Some strands of PC theory posit the emergence of government itself as a rational response to the problems of privately supplying public goods (the logic is founded on the theory of collective action). Many of the important public services provided by the state (protection, redistribution, social services) could not effectively be provided by individuals, because the incentives which individuals face discourage it. The services in question are those from which individuals cannot be excluded once the service is supplied (for example, national security), hence they have no incentive to contribute to the procurement.

The growth of government too has been explained as a rational process which is conditioned by the actions of political entrepreneurs. In similar terms, PC has analysed constitutions, legislatures, property rights, regulation, bureaucracies and tax structures. The emphasis in analysing political institutions is placed on how they function, both in terms of fairness and efficiency in meeting the needs of civil society (that is, the normative aspect). The major institutional questions posed by PC

smack of this dual concern. How can taxes be administered in ways that effectively extract resources from individuals in ways that conform to their marginal valuation of public goods? How can property-right law be structured so as to maximize individual incentives to generate economic wealth? How can economic regulation be promoted in ways that maximize industrial activity? How can wealth be distributed in ways that society deems fair or just? How can legal structures be organized so as to promote efficiency and fairness in democratic society? One issue under this latter question regards the use of constitutional amendments to constrain capricious behaviour on the part of political entrepreneurs. PC has highlighted the incentives for political leaders to irresponsibly manipulate MACRO-ECONOMIC POLICY to win elections (over-spend, over-inflate). Constitutional amendments which instituted balanced budgets and stable-money rules (for example, a gold standard) would diminish the ability of politicians to distort the macro-economy in that way. PC has underscored similar problems in bureaucracies and legislatures. Bureaucracies are too large, bureaucratic output lacks rational coherence and bureaucrats work well below full efficiency. Legislatures devolve into patronage systems, output reflects compromise (log rolling) rather than rational coherent policy, and legislators are out of touch with the individuals they represent. Overall, it is a fundamental conclusion of PC theory that democracy produces significant inefficiencies with respect to providing output that accords with social preferences. Much of normative PC theory is oriented around eliminating these inefficiencies.

A dominant strand in normative PC relates to the creation of institutions that produce political outcomes that are fair. Much of the analysis in this vein has unfolded within questions of distributive justice. Rawls (1971) has been influential in this ongoing debate. Rawls' arguments are generally reflective of an emphasis on optimal *ex ante* rules or laws as a means of assuring distributions of resources that are considered just.

There is a sizable literature on the economic

public goods

analysis of international politics which reflects all of the major strands of PC theory. Applications have come in all of the principal subject areas in international politics: trade, bureaucracy, diplomacy, war, alliance behaviour, foreign aid, sanctions, foreign investment, environment, monetary and financial relations, decision-making, international organization, foreign policy-making, debt and development.

See also:

collective action; free rider problem; international political economy (IPE); Olson, Mancur; public goods; rational choice; revealed preferences

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GIULIO M. GALLAROTTI

public goods

'Public goods' (as distinguished from 'private goods') are non-rival and non-excludable, which means that consumption by one does not detract from what is available to others and that access is available to all (or at least that exclusion costs are prohibitive). These properties lead to pricing inefficiencies and the market's under-supply of public goods. Non-rivalness gives rise to a 'preference-revelation' problem, in that the demand for the good cannot be gauged from consumption patterns. Non-excludability gives rise to a FREE RIDER PROBLEM, in that non-contributors enjoy the same access to the good as do contributors. Different combinations of the two properties characterize a class of goods between the purely public and the purely private, referred

to as 'impure public goods'. For example, where exclusion is possible, the free rider problem may be overcome by denying non-contributors access to the good. However, exclusion may not facilitate COLLECTIVE ACTION if the benefits among contributors are at least partially rival, in which case a 'toll' mechanism may be required to help overcome the preference-revelation problem, as in common pool resource dilemmas.

Versions of HEGEMONIC STABILITY THEORY variously interpret FREE TRADE as an example of a pure (Kindleberger, 1973) or impure (Gilpin, 1981) public good, given expectations about the potential for exclusion. Theories of international security variously interpret a military alliance as an example of a pure (deterrence) or impure (defence) public good (Olson and Zeckhauser, 1966), given expectations about the degree of rivalness of benefits accruing to contributors. Most examples of public goods are impure.

See also:

externalities

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and political implications of pure and impure public goods.

MARC L. BUSCH

public sector

The 'public sector' is that part of the economy owned or controlled by public authority or government. With the rise of CAPITALISM, the role of the public sector was increasingly confined to protecting by law and extending by armed force private capital holdings across domestic economies and foreign territories. Locally regulated common lands, a non-governmental forerunner of the public sector, were correspondingly delegitimized and privatized. Large-scale PRIVATIZATION emerged with massive enclosures of common lands after 1400, and re-emerged in a new form in the late twentieth century with privatizations and liquidations of public-sector enterprises and services across the world.

The public sector has evolved in three distinguishable ways, two of which are instrumental to non-public ends: (1) state expenditure and infrastructure to serve the private sector as protector, adjudicator and developer of private property and investment (the dominant conception of liberal and market theory); (2) the public sector as a government bureaucracy serving its own interest in self-expansion (as in late Napoleonic or Stalinist state apparatuses), and (3) the public sector proper – social expenditure and infrastructure to provide non-priced public goods like universal education and healthcare, a pollution-free environment and social security for all citizens. Although these three conceptions of the public sector are in principle opposed, they are usually confused, with (3) attacked because of (2), for example, or (1) believed to achieve (3). In the twentieth century, a dramatic rise of the public sector proper occurred after 1945, a growth which was reversed after 1980 by a combination of rising debt charges and anti-Keynesian monetarist policies (see KEYNESIAN ECONOMICS; MONETARISM), and the collapse of

purchasing power parity (PPP)

state socialist societies under the weight of the military-industrial expenditure of the Cold War (see COLD WAR; STATE SOCIALISM). This policy-led bankrupting of social infrastructures was represented as 'necessary free-market reforms' on both sides of the former superpower conflict.

Subsequent to this transnational market restructuring of economies, the need for a strengthened public sector proper re-emerged with a deepening planetary crisis of private-sector pollution, resource exhaustion and systemic disemployment after 1990. But since the dominant market ideology regarded government's legitimate function as serving the private sector by protection of market PROPERTY RIGHTS and contribution to globally competitive enterprise, the public sector proper continued to be reduced and privatized precisely as the need for its non-priced functions increased. With the 'race to the bottom' of transnationally mobile corporations seeking to achieve lower cost inputs for stockholders by DEREGULATION and down-pricing of labour and resource inputs, the protection of social and environmental life-hosts by common standards of human rights, social security and environmental protection became a deepening imperative of world life security. Post-1988 transnational trade and investment agreements, however, recognized only the neotenic sense (1) of the public sector and excluded all rights to non-priced goods provided by government from their regulatory protections.

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JOHN McMURTRY

purchasing power parity (PPP)

'Purchasing power parity' (PPP) describes a relationship between exchange rates (see EXCHANGE RATE) and prices, originally put forward in the seventeenth century by the mercantilist Gerard de Malynes, but later formalized by Gustav Cassel (1930) when he introduced PPP theory. This theory states that the exchange rate between two currencies is in equilibrium when their domestic purchasing powers at that rate of exchange are the same.

PPP begins from the premise that the price, in terms of a common currency, of any tradable commodity in any two markets will differ at most by the cost of transport, tariffs and the differences in retail costs involved in moving goods from one market to another. For example, let us consider two countries – say Denmark and Sweden – and assume that they produce only tradable goods. We shall also assume that the goods produced by these two countries are homogeneous (for example, a toaster produced in Denmark is identical to a toaster produced in Sweden), that there are no barriers to international trade (transaction costs or tariff barriers), that there is full employment, no transportation costs and that the price system efficiently allocates resources. Under these circumstances, the price of a toaster in Denmark must equal the price of an identical toaster in Sweden, multiplied by the spot exchange rate. If these conditions did not hold, it would be profitable for arbitrageurs to trade goods from one market to another. For example, if Danish toasters were cheaper than Swedish ones, it would be profitable for economic agents in Denmark to buy the good in Denmark, transport it to Sweden and sell it at the higher price. In the same way, it would be profitable for speculators in Sweden to convert their funds into Danish krone, buy the good in Denmark and transport it to Sweden. This process of ARBITRAGE would continue until it was no longer profitable to continue and prices between the two countries were equalized.

The mechanics of this adjustment process are different depending on whether exchange

rates between the two countries are fixed or flexible. If they are fixed, then the price of a good will rise in Denmark and fall in Sweden as the commodity is arbitrated to Sweden. If, on the other hand, the exchange rate is perfectly flexible, then the price of a good will stay fixed both in Denmark and Sweden, and equilibrium will be restored by a change in exchange rates rather than an adjustment in the price level. If we argue that these conditions hold for all the goods in the economy, then we say that 'purchasing power parity' has been achieved.

Cassel's interpretation of the theory was based on changes in, rather than absolute levels of, prices and exchange rates. He maintained that declining values in the FOREIGN EXCHANGE markets during the 1920s were caused by INFLATION that resulted from unbalanced budgets increasing the quantity of money. This argument has, however, been called into question as, in practice, exchange rates (which are determined by the demand and supply of currency in the foreign exchange markets) are related to elements such as disequilibrium in a country's BALANCE OF PAYMENTS, speculation, capital transactions and government policy. Moreover, many domestic goods and services are not traded internationally. Their relative prices are thus not taken into account in the determination of a country's exchange rate value. It is also impossible to measure satisfactorily what purchasing power a currency in one country has relative to that in others, because it is so difficult to determine the appropriate basket of commodities that should be taken into account in order to measure the average price level. This means that it is difficult to

make international comparisons of standards of living that are based on current exchange rates.

Nevertheless, the concept of PPP has assumed more significance recently because of its relevance to ECONOMIC AND MONETARY UNION (EMU) in Europe. In a monetary union, where exchange rates are fixed and there is a single currency in operation, purchasing power parity can be used to explain the change in reserves caused by the international exchange of commodities. Indeed, Paul de Grauwe (1994) considered the achievement of PPP to be the equilibrium position for countries within a monetary union. If this were not the case, then if (say) Denmark's rate of inflation was larger than Sweden's, Denmark would have to depreciate its currency to leave the competitiveness of its products in the international marketplace unchanged.

See also:

fixed exchange rates; floating exchange rates

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ALISON M.S. WATSON

Q

Quadrilateral Group of Trade Ministers ('the Quad')

The Quadrilateral Group of Trade Ministers ('the Quad') was established at the 1981 GROUP OF 7 (G-7) summit. It meets regularly at ministerial level and frequently at official level to discuss multilateral trade issues. It is an informal grouping, with no operational responsibility; its significance, therefore, is comparable to that of the G-7 itself. Participants are the European Commission (which has EUROPEAN UNION (EU) competence for trade policy under Article 113 of the TREATY OF ROME), Canada, Japan and the United States. They are the world's four largest trading entities, a status recognized in the WORLD TRADE ORGANIZATION (WTO) Trade Policy Review Mechanism, where they are the only members subject to surveillance every two years, rather than every four or more years. Quad leadership can be essential for the WTO since, unlike the WORLD BANK and the INTERNATIONAL MONETARY FUND (IMF), no power is delegated to a smaller executive group. The Quad played a significant role during the URUGUAY ROUND, as they did in a more informal way during previous Rounds, since one or other of the Quad members tends to be the largest trading partner for all other WTO members. Recently the Quad has been working at officials' level with the other members of the 'Invisibles Group' – Argentina, Australia, Brazil, India, South Korea, Morocco, New Zealand, Norway, Poland, Singapore and Switzerland.

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ROBERT WOLFE

quality of life

Traditional measures of development have focused on GROSS NATIONAL PRODUCT (GNP). New measures look at actual measures of people's quality of life based on life-span, education, access to clean water and nutrition, healthcare, equal economic opportunity for women, environmental quality, sometimes political and civil rights, and similar variables. These measures, such as the United Nation's Human Development Index, more accurately reflect quality of life. Clean water would indicate a higher quality of life, while polluted water would indicate one that is lower, whereas under the old measures, water pollution from an oil spill, for example, would add to GNP and show up as improved economic development.

PAUL G. HARRIS

quantity theory of money (QTM)

The quantity theory of money (QTM), dating back at least to the mid-sixteenth-century Spanish scholastic writers of the Salamanca School, is one of the oldest theories in economics. Modern students know it as the proposition stating that an exogenously given one-time change in the stock of money has no lasting effect on real variables, but leads ultimately to a proportionate change in the

quantity theory of money (QTM)

money price of goods. More simply, it declares that, all else being equal, money's value or purchasing power varies inversely with its quantity.

There is nothing mysterious about the quantity theory. Classical and neo-classical economists never tired of stressing that it is simply an application to money of the ordinary theory of demand and supply (see NEO-CLASSICAL ECONOMICS). Demand-and-supply theory, of course, predicts that a good's equilibrium value (or market price) will fall as the good becomes more abundant relative to the demand for it. In the same way, the quantity theory predicts that an increase in the nominal supply of money will, given the real demand for it, lower the value of each unit of money in terms of the goods it commands. Since the inverse of the general price level measures money's value in terms of goods, general prices must rise.

In the late nineteenth and early twentieth centuries, two versions of the theory competed. One, advanced by the US economist Irving Fisher, treated the theory as a complete and self-contained explanation of the price level; the other, propounded by the Swedish economist Knut Wicksell, saw it as part of a broader model in which the difference, or spread, between market and natural rates of interest jointly determine bank money and price-level changes.

The contrasts between the two approaches were striking. Fisher's version was consistently quantity-theoretic throughout and, indeed, focused explicitly on the received classical propositions of neutrality, equiproportionality, money-to-price causality, and the independence of money supply and demand. By contrast, Wicksell's version contained certain elements seemingly at odds with the theory. These included (1) a real-shock explanation of monetary and price movements, (2) the complete absence of money (currency) in the hypothetical extreme case of a pure credit economy and (3) the identity between deposit supply and demand at all price levels in that same pure credit case rendering prices indeterminate.

Although the quantity theory has had a long history, it fell into disrepute in the 1930s, partly because it seemed at the time that this theory could not explain the GREAT DEPRESSION and partly because of the publication in 1936 of Keynes's theory (see KEYNES, JOHN MAYNARD). Although some economists continued to advocate the quantity theory, most economists became Keynesians and treated the quantity theory as a historical curiosity (see KEYNESIAN ECONOMICS).

Only in the mid- and late 1950s did the quantity theory again become a serious rival to the Keynesian theory. There were several reasons for the revival. First, contrary to the predictions of many Keynesians, on the conclusion of World War II the US economy did not revert to the depressed conditions of the 1930s, but instead underwent INFLATION. Second, one seemingly great benefit of the Keynesian revolution had been its demonstration that by manipulating expenditures and taxes, governments could keep their economies close to full employment. But it turned out that there were serious political as well as economic difficulties in actually changing government expenditures and tax rates in these recommended ways, and that Keynesian theory appeared to be less useful than it had originally seemed.

However, the resurgence of the quantity theory should not be attributed merely to impersonal historical events. It is also due to the fact that several extremely able economists advocated quantity theory. Don Patinkin, of the Hebrew University, restated the quantity theory in a rigorous way that avoided many of the crudities that infested earlier expositions. MILTON FRIEDMAN, of the University of Chicago, and many of his former students provided a framework that allows one to test empirically the proposition that changes in the quantity of money dominate changes in income. Moreover, Friedman and Anna Schwartz, of the National Bureau of Economic Research, argued in a lengthy study that the experience of the Great Depression should be interpreted as confirming the predictions of the quantity theory rather than Keynesian theory.

Subsequently, they showed that in both the United States and the United Kingdom, longer-run movements in nominal income were highly correlated with movements in the money stock.

Despite the resurgence of the quantity theory in the 1970s and early 1980s, it is still far from universally accepted by economists. Controversies about its validity and applicability rage on. In his masterful survey, David Laidler noted that:

Controversy about the Quantity Theory has been marked by common themes since the 18th century. These include the definition of money, the relationship between correlation and causation, and the transmission mechanism. Controversy has continued because of the technical difficulty of sorting out the direction of causation running between money and prices, and, on a deeper level, because ideological concerns about the viability of market mechanisms are at stake in the controversy.

(Laidler. 1991: 223)

See also:

Chicago School; monetarism

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ROBERT LOONEY

quotas

Quotas are binding restrictions on the amounts of certain goods that can be imported into, or exported from, a country. Import quotas are usually employed to deal with BALANCE OF PAYMENTS problems or to protect domestic industry; export quotas are usually employed to control the supply of goods to the world market. Both types of quotas can generate RENT-SEEKING behaviour and both can be replaced by TARIFFS, which produce similar effects without rent-seeking.

Import quotas may be set unilaterally by a government. One reason for their imposition can be a severe balance of payment deficit. Import quotas can be used in such a situation to limit the value of total imports to below the expected value of total exports. Import quotas were often imposed by European countries immediately following World War II for this reason. Another common type of import quota is designed to protect or stimulate domestic industry. The United States and the EUROPEAN COMMUNITY (EC) have used import quotas to protect their domestic agricultural sectors throughout the post-war period. Developing countries have also used import quotas to protect infant industries and promote IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI).

To implement import quotas, the government typically distributes import licences. Since the quota limits supply, it increases domestic price and the import licences become entitlements to the rents thus created. Rent-seeking behaviour often results, as importers compete for access to these licences. Rent-seeking behaviour can be avoided if the licences are

quotas

auctioned off at prices equal to the rents; however, this is not a common method for distributing them.

Export quotas are generally agreed to in multilateral negotiations. COMMODITY AGREEMENTS between exporting and importing countries usually aim to smooth out supply fluctuations with the goal of stabilizing world market prices for that commodity. The INTERNATIONAL COFFEE AGREEMENT (ICA) is an example of one such agreement with negotiated export quotas. CARTELS usually aim to restrict supply with the goal of raising prices. The ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) is the best-known example, in which production quotas are negotiated among oil producers. Export quota systems are prone to FREE RIDER PROBLEMS, because they provide an incentive for small exporters to exceed their quotas in order to obtain additional export revenues.

Export quota systems often produce an average world market price somewhat above the average equilibrium price. This occurs because export quotas can provide a floor under the price, but cannot provide a ceiling over the price in situations of extremely short supply. Export quotas can thus create rents at both international and domestic levels. At the international level, governments may engage in rent-seeking behaviour to increase their quota; at the domestic level, the use of export licences can create rent-seeking behaviour in the same way that import licences do.

For any quota, there is a theoretically equivalent tariff that will produce the same decrease in imports or exports and therefore the same effects on the balance of payments, domestic protection or limitation of supplies.

However, there are several important differences between the quota and the tariff. First, the quota tends to promote rent seeking while the tariff does not. Related to this, a tariff provides revenue directly to the government, instead of creating rents: the government must auction the licences to capture any revenues under a quota. Second, a quota has a more certain effect than a tariff, since the quota limits imports or exports to a fixed quantity; a tariff has a less certain effect, since the resulting quantity of imports or exports depends on supply-and-demand curves which are usually unknown. Third, import quotas have the potential to create domestic monopolists, while tariffs do not. This occurs because under a tariff increased demand is met by an increase in imports, whereas under a quota it results in a price increase. Under a tariff, a domestic producer must still compete with imports at a price equal to the world market price plus the tariff, whereas under a quota there is potentially no limit to price increases. Finally, an export quota system tends to protect inefficient producers. This occurs because export quotas are generally not allocated on the basis of relative costs of production. Therefore, changes in world demand are generally met by proportional increases or decreases in all quotas, rather than expansion of production by the most efficient producer or reduction of production by the least efficient.

See also:

voluntary export restraints (VERs)

JOHN M. TALBOT

R

race

The concept of 'race' has had a controversial history. It can be defined as 'the social significance attached to physical traits that have a bearing on action and attitude' (Smith, 1989). The categorization of human societies goes back to Herodotus who described fifty different 'peoples' in his histories. Since then, the extension of communications and human contact have further complicated the picture. The history of the study of 'race' abounds with imprecise concepts, such as Aryan, Caucasian and Mongoloid. 'Race' is defined on the basis of different physical characteristics, which are supposed to influence language, physical prowess, religious belief and intelligence. Some of these concepts are still used today, especially in medical publications. Social scientific definitions of 'race' emphasize the idea of a social construct, embedded in the era of slavery and colonialism, which was discredited after years of resistance, political action and debate about the consequences of such actions. These pressures were supported by the realization of the effects of the implementation of social policies premised on 'race' by the Third Reich, and policies of racial segregation in the United States and apartheid in South Africa.

A number of RACIAL THEORIES developed in the second half of the nineteenth century, linking physical characteristics (such as head shape and bodily characteristics) to behaviour and intelligence. These were formalized into pseudo-scientific theories like craniology and eugenics – the latter a belief widespread in the 1930s about the possibility and desirability of breeding a superior human population. Perhaps the most virulent form of 'race' theory

was Nazi theory, later taken up by proponents of apartheid in South Africa, which was based around a strict hierarchy of 'races' which were seen as being quite distinct from one another.

After World War II and the Holocaust, the newly established international machinery, particularly the UNITED NATIONS EDUCATIONAL, SOCIAL AND CULTURAL ORGANIZATION (UNESCO), initiated a series of statements affirming that there was no evidence of innate differences in ability or other characteristics between different 'races' (Guillumin, 1992). The scientific concept was discredited as a useful way of distinguishing between human populations. Within the social sciences, the concept is frequently used within quotation marks (as in this article) to underline the idea that it is a contested notion and of value mainly to understand the socially constructed phenomenon of 'race'.

Ideas of 'race', like ethnicity, are about the classification of populations positively, negatively, neutrally (Goldberg, 1993). They are underpinned by the notion of a 'natural' relation between an essence attributed to a human population (defined in biological or cultural terms) and the social outcomes that flow from this (Anthias, 1998).

The use of the concept 'race' has varied with different national and historical contexts. For instance, in Germany and France it is a highly controversial term, rarely used in academic discourse. In France much effort is expended on explaining the complexity of the human genetic composition: this was the subject of an educational exhibition at the Musée de l'Homme in 1992 (Langaney, Van Blijenburgh and Sanchez-Mazas, 1992). However, in North America and the United Kingdom the terms 'racial' or 'ethnic group' are in current usage.

racial theories

Use of the idea has also persisted in scientific work in Eastern Europe, linking natural and medical science to popular culture and prejudice (Kohn, 1995).

Ideas about racial predisposition to certain forms of behaviour have persisted in psychology, where writers such as Hans Eysenck have argued that there are significant differences in mental processes and abilities between different human populations or 'races' (ibid.: 149). Studies of intelligence raise the difficult and controversial methodological problems of how to compare learned intelligence between individuals or groups in different environments (Herrnstein and Murray, 1994).

New understandings of genetics have revolutionized the study of 'race'. The recent Human Genome Diversity Project and the Eurasia 98 project involve genetic or molecular anthropology. The method is to examine and compare sequences of human DNA to find clues to the history and origins of pockets of people who have lived in the same place for centuries and to trace the path of particular genes through the centuries. These studies have tended to confirm the theory that genetic variations between 'races' are trivial when compared with genetic variations between individuals within a particular group.

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racial theories

The concept of RACE is modern, having emerged originally out of the extensive encounter between European and non-European peoples as a result of colonial expansion and the rise of Western CAPITALISM. Most contemporary social scientists do not view 'race' as a biological or genetic category, but rather as a social construct in which the social significance that people attach to various physical traits creates meaning, and generates racial boundaries and ultimately RACISM. Because diverse populations are socially defined, racial theories often overlap with the study of ETHNICITY as an arena for inter-group interaction in modern societies.

Modern social science has been divided in its treatment of race and ethnicity. While some scholars viewed social evolution as a progression towards modernization and structural integration of differences into a culturally functional or homogeneous framework, other researchers saw racial (and ethnic) conflict as ubiquitous and inherently associated with COLONIALISM, capitalism and social stratification. In the area of POLITICAL ECONOMY, the theoretical approaches to racial (and ethnic) relations can be broadly divided into an evolutionary/assimilation perspective and a conflict/power perspective.

Evolutionary/assimilation theorizing grew out of basic concepts of social evolution and modernization. The perspectives of 'dominant culture' and 'melting pot' were formulated to illustrate the structural and cultural approaches to race relations, based on the dynamics of modernization of core structures, institutions, values and culture. GUNNAR MYRDAL developed a 'cultural consistency' thesis; Robert Park formulated his 'contact hypothesis', and Milton Gordon's model of structural and cultural assimilation became

perhaps the standard integrative model within the evolutionary/assimilative school of racial theory.

In general, the 'dominant culture' tradition has seen the mainstream culture as an essentially finished product and insisted that immigrating racial and ethnic groups give up their own cultural traits for those of the dominant cultural group. The 'melting pot' tradition has perceived assimilation as a process by which peoples and cultures would fuse within the core national structures to produce a new people and national hybrid culture. Any groups that were not normatively synchronized with the dominant structure and culture were viewed as either fixed at a less-developed phase of evolution or were defined as racially or culturally inferior until they could demonstrate evolutionary advance, integration and assimilation into the dominant cultural mould.

Evolutionary/assimilation or structural/functional models which sought to emphasize the social forces contributing to stability and consensus dominated mainstream analysis of race relations in the social sciences until the 1960s, when they were challenged by the conflict/power or coercion perspectives. The conflict perspectives were based on the contention that assimilationist theory justifies dominant ideology, reinforces racial and cultural superiority, maintains stratification and inequality, and ultimately fails to reduce the prejudice and discrimination resulting from social structures that block the social mobility of racial and ethnic minority groups.

Drawing on the Marxist tradition (see MARXISM—LENINISM), the conflict/power perspective views racial and ethnic prejudice and discrimination as emerging from the process of production and market dynamics, which give rise to racism as manifested in segregation, expulsion and even extermination. While conflict theories differ from one another, they nonetheless share the common theme of power and coercion in race relations, as is evident in class theory, internal colonialism, split labour-market theory, 'middle-man' minority theory and the notion of ethnic enclaves.

Modern class theory posits that class and race are interactive and inseparable in modern multi-ethnic societies. Racial/ethnic differences commonly coincide with class/economic differences and the two become mutually reinforcing, sustaining inequality and stratification. Class theorists contend that the elite class uses prejudice and discrimination as a means to serve its own interests. The WORLD-SYSTEMS THEORY of IMMANUEL WALLERSTEIN further spatializes class relations on a global level by tracing racial and ethnic discrimination to the unequal relationship in the world economic system between the 'core' region of dominant and exploiting nation-states and the 'periphery' of subordinated and exploited nation-states (see CORE—PERIPHERY MODEL).

Michael Hechter's theory of 'internal colonialism' presents another insightful view on the relationship between race and class. Besides the classical form of Western global colonialism that characterized European domination and exploitation of peripheral poor countries, colonialism can also take place internally within a country in which certain economically and culturally disadvantaged racial or ethnic groups are exploited and discriminated against by a 'core' or dominant group. The theory of internal colonialism has been popularized in the social sciences by the powerful work of Robert Blauner, who has argued that blacks, Indians and Chicanos in the United States have been exploited, excluded and internally colonized. Hechter made a similar claim for Celtic groups, such as the Welsh, in the United Kingdom.

Another perspective within the conflict school is the split labour-market theory of Edna Bonacich, who argues that inter-group tension does not only arise out of the exploitation of workers by capitalists, but in addition is a by-product of the efforts of higher-paid labourers to resist being displaced by cheap labour in a racially or ethnically divided working class (see CLASS, WORKING) — capitalists can also take advantage of racial divisions to divide workers against each other.

'Middle-man' minority theory and ethnic enclave theory are also oriented toward social conflict between racial or ethnic groups. These

racism

models focus on how racial and ethnic minority small-business enterprises struggle to survive in the largely dominant-group controlled economy: a group of 'middle-man' entrepreneurs has emerged, mainly because of limited economic opportunities provided to minority peoples who are constrained by unequal structural arrangements in society, and they struggle to survive by occupying certain occupational niches that present no (or few) opportunities to compete with the dominant group.

According to the research of Alejandro Portes, entrepreneurs in such groups (especially recent immigrants) develop their own business networks to meet the needs of their own people and community. These business networks thus create a distinct market-space for themselves in big metropolitan cities of the advanced capitalist world; they have become known as 'ethnic enclaves'. From the conflict perspective, 'middle-man' entrepreneurs and ethnic enclave economies illustrate a deeply stratified modern economic system that has reinforced, rather than diminished, racial and ethnic boundaries in modern capitalist society. Such dynamics will be more likely to continue as racial and ethnic groups further seek their places in the emerging global political economy.

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JIELI LI

racism

The term 'racism' refers to the theory that human characteristics and abilities are deter-

mined by RACE and to the practices of hostility towards and annihilation, sterilization, separation (apartheid) and deportation of the excluded 'races'. It has largely replaced the older term 'racialism'. The idea developed in the eighteenth and nineteenth centuries to explain the hierarchy of interdependence between different groups of people and to justify differences in productive relations and material wealth. Racism was often bound up with nationalism and helped to form certain national identities. With the decline of empire, racialized discourses focused on internal boundaries within NATION-STATES, notably between ethnic minorities or migrant populations and the majority. There is a history of racism against Jews, Muslims, blacks, gypsies, and indigenous and colonized populations.

The concept of 'racism' has received a great deal of attention in recent years and attempts to define it have focused on racism as practice (institutional and 'everyday' racism) and racism as prejudice or belief (individual and psycho-social racism), even theorizing the idea of the authoritarian personality, prone to racism. Underpinning the practice and belief are assumptions that human attributes are determined by 'race', defined biologically or culturally. In the post-1945 period, racist theories have tended to shift from a focus on biological characteristics to cultural characteristics, although there have been recent attempts to revive the biological components through the use of genetics and psychological tests (Kohn, 1995; Rex, 1970; UNESCO, 1951).

Theorizations of racism have focused on the complex social and historical relations involved. It is a fluid, transforming, historically specific concept, parasitic on theoretical and social discourses for the meaning it assumes at any historical moment (Goldberg, 1993: 74). Floya Anthias argues that racisms are discursive, systemic and intersubjective practices and outcomes of social relations, not emanating exclusively from ethnic or race categories, but capable of linkage to broader social processes like class and gender (Anthias, 1990; see also Balibar and Wallerstein, 1991; Guillaumin, 1995). A recent definition of racism in the

United Kingdom highlights the complexity of the concept: 'conduct or words or practices which advantage or disadvantage people because of their colour, culture or ethnic origin. In its more subtle form it is as damaging as in its overt form' (Macpherson, 1999: para. 6.4).

Although most theories of racism would qualify the well-known formula 'racism is prejudice plus power', current theorists agree that racism is a form of social division which rests on differential power relations. The pernicious impact of racist ideas emanate not from individually held prejudices, but from the way in which they are hegemonic, embodied in the words and actions of different individuals in different contexts. Racist ideas are the products of discursive and material forms, and operate in a contested and negotiated field (Anthias, 1999). Racism is not necessarily the province of the socially privileged; racist violence is often perpetuated by underprivileged youth attempting to protect what they perceive as their territory and may thus symbolize their lack of power (Cohen, 1992).

The intent of the actor and the perception of the act by the victim are also important, especially in the enforcement of anti-discrimination legislation. What evidence can be used to judge racist motivation and how can it be obtained? Some would advocate perception as the only criterion of the racist act, others would expect it to be supported by procedures which are publicly accountable and transparent. The difficulties of defining racism are compounded by its opportunistic, fluid, shifting character, which evades clear definition.

Racism operates as a sphere of social relations within specific economic, political and ideological conditions. This is highlighted by the way in which a group may be defined as a target of racism in different ways at different times: for instance, Jewish people have been sometimes identified by physical features, or as a cultural or religious group. The racial categorization may also depend on factors of class and gender. Racial hierarchies are complex and can be 'read' across a range of different dimensions. This helps to explain the emergence of apparently 'new' forms of racism,

such as 'ethnic cleansing' – a euphemistic term used to describe the violent removal of whole populations defined by their ethnicity from certain territories during the war in the Balkans in the 1990s (Korac, 1998).

The concept of *everyday racism* emphasizes the casual and taken-for-granted use of racist stereotypes in popular discourse, and focuses on the daily experiences of individuals in an approach which combines macro-/micro-sociology, social psychology, discourse analysis, race-relations theory and feminist theory. Everyday racism is 'infused into familiar practices', so that it has a cumulative effect (Essed, 1991). Other analyses have focused on the impact of racism and stereotyping in the media and popular culture (Hall, 1992; Pieterse, 1992).

The idea of *institutional racism*, developed in the United States through debates in the Black Power movement (Allen, 1973; Marable, 1995; Williams, 1985). According to this view, racism 'permeates society on both the individual and institutional level, covertly or overtly' (Carmichael and Hamilton, 1968: 21). Sivanandan argues that racism is a tool of class domination, necessary only for the purposes of exploitation and division, and thus institutionalized 'racialism refers to attitudes, behaviour, ... racism is the systematisation of these into an explicit ideology of racial superiority and their institutionalisation in the state apparatus' (Sivanandan, 1982: 170). Alongside this idea of systemic, institutionalized racism, developed the concepts of indirect discrimination and racial disadvantage, used as tools in the enforcement of legislative measures to combat racism. A distinction was drawn between overt or direct acts of racism and disadvantage through 'unwitting prejudice', ignorance, thoughtlessness and racist stereotyping which disadvantage minority ethnic people (Macpherson, 1999).

A range of studies have focused on institutional processes, such as racial violence, direct/indirect discrimination, exclusion from local, national and transnational/global politics, sentencing or criminal justice and immigration policy, which shape the position of racialized

rational choice

minorities. Because racism is plural and complex, we need to understand how contemporary racisms have evolved and adapted to changing circumstances.

Robert Miles draws attention to the difficulty in distinguishing between racism and the effects of class or gender inequality, preferring to see racism as an IDEOLOGY (Miles, 1989). This implies that racism permeates all forms of systematic exclusion and differential treatment using any form of collective attribution including ethnicity, colour or culture. A relatively new form of exclusion arises from essentialist notions of difference, promoted by ethnic and religious fundamentalist movements. Similarly, in recent years undocumented workers and asylum-seekers have become targets of racism.

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RAMADAN WAR see Yom Kippur War

RATIONAL ACTION see rationality

rational choice

Over the past few decades, rational choice theory has become one of the fundamental approaches utilized in the study of political science and, in particular, is useful as an aid to understanding issues of international political economy (IPE). For example, a lot of classical realist theory (see REALISM) is based on the assumption that decision-making is done by rational actors aiming to pursue the goals of the state as effectively as possible. Indeed, some of the most significant contributions of rational

choice theory have demonstrated the difficulties involved in such assumptions in conflict situations.

The rational choice revolution began in the 1950s when its use in the analyses of the conduct of elections and in the understanding of the outcomes of the rivalries between political parties gained popularity (Downs, 1957). Since that time, the approach has been widely used in the political science literature to analyse government decisions that are based on the interests of individual actors and the constraints that they may encounter.

Rational choice is a positive theory, in that it aids understanding. It is, however, normative in the way that it has little itself to say about what should actually be. Rational choice is thus not a theory of political behaviour in the way that LIBERALISM, for example, is. Rather, it is a way of understanding interactions between political actors in which the self-interest of the actors is an important motivating factor. Rational choice theory, then, very much echoes the fundamentals of liberalist behaviour, where the quest for individual utility-maximization is paramount. In other words, under rational choice theory, when individuals are faced with a range of choices, they will choose the one that they believe best serves their objectives. Underlying rational choice theory is, then, the notion that the aggregation of individual preferences and actions will afford an accurate representation of the preferences of the group as a whole.

In addition to this is the notion that individuals will act so as to maximize the expected value of the outcome of their decision, measured on some utility scale. In other words, individuals will act so as to maximize their utility within the limits of what they consider to be the most beneficial way to achieve their objective. This is usually done by attaching some numerical value to particular outcomes. This allows for actions that are, on the face of it, irrational but that, in actuality, represent the most efficient method of achieving a goal. Nevertheless, rational choice theorists and economists have, in general, had some difficulties in integrating the dilemmas that are inherent in any information-gathering

process with the operation of rational decision-making and, in particular, with the idea that people are unable to act in a completely rational manner at all times. In addition, because of limitations in the process of information-gathering, individuals must often move to a form of 'next-best' rationality. For example, if an actor were to stop searching once their preferences had been satisfied but not maximized, it could be said that the actor had a preference for 'satisficing'. One thing that must be re-emphasized here is that the relevant agents in the rational choice decision are individuals. The task, then, for rational choice theorists is to explain the collective outcome with reference to the maximizing actions of individuals.

Moreover, in pursuing this goal, there are certain consistency requirements that are part of the definition of rationality. In particular, to successfully predict the actions of an individual from their preferences, those preferences must be ordered in some way. Thus an individual is assumed to act to maximize x if they prefer x to y and so forth. If the individual has no particular ordering of preferences, or if those preferences constantly fluctuate in their values, it would be difficult to then predict action from preference. In other words, it is possible for an agent's available options to be rank-ordered (displaying what is sometimes called 'connectedness') – meaning that an individual may regard any two available outcomes as either unequal (one is preferred to the other) or equal (the individual is indifferent between the two) – and that the order of preference between choices is transitive (if a is preferred to b and b is preferred to c , then consistency requires that a be preferred to c). This notion of transitive preferences is crucial to understanding the logic of rational choice theory.

Finally, individuals are (barring some drastic situation) assumed to be generally rational in the traditional sense. That is, they efficiently (within certain bounds) search for information, make decisions based on that information in a manner that is consistent with the weighing of preferences, and they then act in a manner which maximizes the expected value of the

rational expectations

preferences. In other words, within bounds, individuals – when faced with a particular decision – will gather data, match that data with their given preferences and then act on their conclusions.

In recent years, there has been a large amount of critical analysis regarding the nature and usefulness of rational choice theory. In particular, the theory has been criticized for not taking into account the significance of factors such as culture in informing an individual's decision. In addition, there are felt to be weaknesses, at times, regarding the analysis of group and altruistic behaviour in demonstrating rational choice. Although this does not negate the usefulness of rational choice theory, it does tend to suggest that rational choice theory may be most useful when used in concert with other approaches.

See also:

structuralism; world-systems theory

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ALISON M.S. WATSON

rational expectations

'Rational expectations' or the 'rational expectations hypothesis' were introduced into economic theory by Simon F. Muth (1961). The concept was first applied by Muth to the problem of trying to predict the future price of goods (such as agricultural products) that took a significant amount of time to produce. The concept was further developed and famously applied to macro-economic theory by Robert E. Lucas, leading to the formation of the influential school of thought known as 'New Classical Economics'. Although initially treated with much scepticism, the rational expectations hypothesis is now commonly accepted as a central part of mainstream economic models.

Muth's straightforward but powerful insight was to suggest that actors behave rationally when forming their expectations. Therefore, if an actor conforms to the rational expectations hypothesis, standard micro-economic assumptions may be applied to the process of the formulation of forecasts of future variables. This implies that the formation of expectations may be viewed as a constrained maximization problem – that is, agents will maximize the accuracy of their forecasts given the information available to them. When actors form their expectations rationally and have full information – that is, access to all the information relevant to the forecast of a variable – they are often described as 'fully' or 'Muth' rational. Although this statement of rational expectations is uncontroversial from the perspective both of economic theory and of RATIONAL CHOICE theory, it leads to some strong conclusions concerning agents' forecasts, particularly if agents are 'fully' rational.

Any economic or political variable an agent wishes to forecast (the 'forecast variable') is often the result of a complex process and is usually influenced by a large number of other variables. It is useful to characterize these influences as consisting of a deterministic component and a stochastic component. The deterministic component consists of all variables that are known to influence the forecast

variable in a quantifiable way; the stochastic component picks up the influence of unknown variables and should follow a completely unpredictable or random path. Under 'full' rational expectations, two strong but related conclusions follow: first, an actor's forecast should correspond to the mathematical expectation of the true process, conditional on the information set available to the actor when the forecast is made; second, since the deterministic component of the process influencing the forecast variable is known, the only difference between an actor's rational expectation of a variable and the actual outcome (that is, the 'forecast error') is the stochastic component of the process. In theory, these conclusions lead to a number of testable implications, two of which we will discuss. First, over a sufficient time-span, actors' forecasts should be correct 'on average'. In other words, the forecast error should be unbiased – that is, it should have a mean of zero and be completely unpredictable. The second implication is that the forecast error should be orthogonal to any information that the actor has at the time the forecast is made – that is, there should be no statistical relationship between the forecast error and the information available to the actor when the forecast is made. Any evidence of such a statistical relationship implies actors are not making use of all available information in a rational way.

The rational expectations hypothesis has been subject to a number of criticisms. As outlined above, it appears to suggest that all actors costlessly gather large amounts of information, process huge amounts of data and undertake complicated mathematical computations in order to calculate a forecast, particularly if actors are assumed to be 'Muth' rational. Critics point out that it is simply implausible to suggest all actors have this capability (either intellectually or financially) and argue that most people are ignorant of the processes that determine many political and probably most economic variables. For example, most people have very little idea how the retail price index is calculated and even less idea how to go about forecasting it. Propo-

nents of rational expectations would largely accept this criticism, although (for a number of reasons) they believe it is unimportant. First, it may be argued that actors do not necessarily need to behave in the way the rational expectations hypothesis suggests in order for it still to be valid. In the real world, actors do not need to undertake the complex mathematical computations and large amount of data-processing that the rational expectations hypothesis suggests. There are many private sector and government institutions that provide forecasts of a wide range of political and economic variables. These forecasts are likely to be rational, or at least very nearly, since the livelihood or reputation of the individual forecaster or institution is at stake. These forecasts are also often available at negligible cost to the public at large via the newspapers and television. A second argument accepts that some actors do not follow the rational expectations hypothesis; however, there is no reason to suppose that with a full information set, these forecasters will all overpredict or underpredict a variable – it is far more likely that some will overpredict and others underpredict. On average, therefore, even if there are significant numbers of forecasters who do not conform to the rational expectations hypothesis, it does not necessarily imply that, on aggregate, the rational expectations hypothesis does not hold.

A further, perhaps esoteric, defence of the rational expectations hypothesis suggests that the usefulness of the rational expectations hypothesis should be judged not as a description of the processes used by an actor when making a forecast, but rather by the accuracy of the predictions made. That is, actors do not have to undertake to gather and process large amounts of data, but rather behave 'as if' they did. An analogy may be useful to help illustrate the point: professional pool and snooker players pot balls for a living, a process that is governed by the laws of angular momentum. However, most players will have no knowledge of these laws, but have learned to behave as if they did. A criticism specifically of 'full' rationality comes from economic theory:

rational expectations

usually it is assumed that an actor will weigh up the costs and benefits of any particular activity and that they undertake that activity to the point where the marginal benefit and marginal cost are equated. When forming expectations, this principle implies actors will gather and process data to the point where the marginal cost of doing so equals the marginal benefit. However, this point may not coincide with a 'Muth' rational forecast. In particular, the point at which marginal benefit equals marginal cost may not correspond to the point where the forecast error is on average zero. However, this criticism (although valid) may be of limited practical relevance. An actor's forecast error may be viewed at negligible cost. Therefore, a consistent overprediction or underprediction of a forecast variable can be easily seen and this information used to costlessly update the forecast.

However, these criticisms (particularly the last two) suggest that it may be unrealistic to expect actors in any situation to always conform to 'full' rational expectations and that there may be short-run deviations from it as rational agents learn from past mistakes and converge towards a 'fully' rational forecast. In other words, the notion of rational expectations is best viewed as an equilibrium concept and does not necessarily hold continuously. In particular, if the deterministic component of the process influencing the forecast variable is unknown or changes, 'full' rational expectations will not hold in the short-run and actors may make systematic forecast errors as they learn (from past forecast errors) about the structure of the deterministic process. However, it is not self-evident that actors who observe their forecast errors over a period of time will necessarily converge towards 'full' rational expectations. This subject is quite complex and has been extensively investigated but, unfortunately, no strong conclusions have emerged. Whether or not actors are able to converge on 'full' rational expectations depends on a number of conditions: first, the form of learning (that is, the rule with which actors update their forecast in the light of previous forecast errors); second, the mathematical

structure of the deterministic component of the process, and, third, the value of the initial forecast relative to the actual value of the forecast variable. However, where actors have correctly identified the variables within the deterministic component of the process, but do not know the precise influence of each of these variables, it may be shown that under quite general conditions actors can learn to form 'fully' rational expectations. Under circumstances where actors have not correctly identified the variables within the deterministic component, it is significantly less likely that actors can learn to become 'fully' rational.

A related problem to this is the so-called 'Peso problem'. This recognizes that, for many variables, the probability of a change in the deterministic process may exist at some point in the future, which will have implications for the rational expectations hypothesis. An example is useful in order to illustrate and clarify the point. In the early 1980s, the Conservative government of the United Kingdom under Prime Minister Margaret Thatcher was committed to very tight monetary and fiscal policies (see FISCAL POLICY; MONETARY POLICIES). This had the effect of (at least) significantly contributing to a historically very high level of unemployment. This meant that the government was deeply unpopular and, at the time, there was a lot of speculation in the media about a change in government policy (referred to commonly as a 'U-turn') and even the possibility that Thatcher would be replaced as prime minister. In the event, there was no U-turn, but any forecaster around this time would have known that there was a significant probability of an increase in monetary growth if the government had so decided. A rational forecast of monetary growth under such circumstances would have been an average of expected monetary growth under the two possible monetary regimes (that is, under the continuation of the existing monetary policy and under a U-turn), weighted by the probability that the forecaster attached to each regime being in place on the forecast date. However, any test of the rational expectations hypothesis would have lead to a rejection of

'full' rational expectations, since the actors' forecast error would have been non-zero on average over the period when it was felt that there was a probability of a change in the government's monetary policy.

A number of researchers have attempted to directly test the 'full' rational expectations hypothesis by directly testing some of the implications outlined above. This exercise has been undertaken for a wide variety of economic variables, such as INFLATION, exchange rates (see EXCHANGE RATE), INTEREST RATES, sales and national output. The evidence is at best mixed: most non-rejections of 'full' rational expectations take place at short forecast horizons (for example, one week into the future) and probably the weight of the evidence suggests a rejection of the 'full' rationality hypothesis. However, caution should be attached to the interpretation of these results for a number of reasons. First, surveys may not correctly measure expectation: agents may not truthfully report their forecasts of economic or political variables. Second, most of the survey data are 'average' expectations and simple averaging may not be the best method of determining aggregate expectations. Third, the rejection of 'full' rationality in most empirical tests, as was discussed above, may be due to the Peso problem or to the fact that rational actors may be learning about the process that determines the variable they are trying to predict. Therefore, although the empirical evidence *may* suggest that 'full' rational expectations do not exist, it does not represent good evidence that agents do not form their expectations in accordance with the rational expectations hypothesis.

See also:

rationalism; rationality

Further reading

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PETER MACMILLAN

rationalism

'Rationalism' may be broadly defined as a commitment to the standards of RATIONALITY. The etymological root from which both words originate is the Latin noun *ratio*, meaning 'proportion'. A 'rationalist', in this broad sense, then, is someone who thinks in terms of proportions or who looks at everything in the world in harmonious proportion to everything else. That is, someone who places special emphasis on the human capacity to think, with precision and coherence, about the manner in which the parts fit together in the whole. But there is another, more technical definition of the word 'rationalism'. Aristotle, for example, used the adjective 'rational' to distinguish humans from animals, but this did not make him a 'rationalist' in the technical sense. Likewise, many philosophers today are firm advocates of the value of reason, yet few are 'rationalists' in the strict sense.

In the technical sense, rationalism is the claim that all knowledge comes ultimately from reason, a philosophy which is generally contrasted with empiricism and the claim that all our knowledge is based on sensory experience. An extreme version of this rationalism rejects the senses as inherently misleading and unreliable. Some rationalists, however, acknowledge that some use of the senses is necessary for the full development of knowledge. All rationalists claim that it is possible to have *a priori* knowledge – that is, knowledge prior to experience. Empiricists admit that some propositions can be known *a priori*, but insist that such propositions are strictly tautological (for example, 'all bachelors are unmarried') and thus give us no knowledge about the world.

Rationalists, on the other hand, are convinced

that we can know some substantive truths about reality through the use of reason independently of sensory experience. Thus, although we do not know what is the cause of any particular event without knowledge of the facts, we do know *a priori* that every particular event has a cause.

Rationalism is often associated with the work of the great seventeenth-century philosophers René Descartes (1596–1650), Benedictus Spinoza (1632–77) and Gottfried W. Leibniz (1646–1716). These thinkers, however, owe a great deal to the classical Greek tradition, particularly to Plato's philosophy that one can achieve insight into eternal, absolute truths about beauty and justice through the intellect alone. It was Immanuel Kant (1724–1804), however, who produced a systematic account of the nature and limits of *a priori* knowledge, distinguishing two kinds of *a priori* propositions: analytical *a priori* and synthetic *a priori*. Analytical propositions are tautological propositions in which the predicate is contained in the subject ('all bachelors are unmarried'). These are the necessary and universal truths of logic, and to deny such propositions is self-contradictory. Synthetic *a priori* judgements, however, are judgements which give us knowledge about the world, although they too are not arrived at on the basis of observation, but are concepts imposed by the mind on the impressions received by the senses.

Kant thus argues that, in experiencing the world, the mind necessarily structures it in terms of what he calls 'concepts of the understanding'. Here Kant is following the traditional rationalist principle of innate ideas, which is the idea that the mind is equipped from birth with certain fundamental concepts. Two concepts of this understanding are the categories of causality and of substance. To give an example, knowing that every event has a cause requires an *a priori* concept of causality, since all that our senses can observe is a certain repetition and regularity in events or a series of correlations between events of type A and events of type B. There is no justification, on the basis of sensory experience alone, for saying that every event must have a

cause. It is the *a priori* concept of causality which allows us to know that objects are necessarily and universally related to each other by causality. Kant, however, rejects the earlier formulation of innatism (advanced by such philosophers as Descartes and Leibniz) according to which innate ideas are completely independent of experience. Kant, instead, concludes that innate ideas (or the categories of the understanding) must be deduced as the very precondition by which we are enabled to make intelligible sense of our experiences.

In the first half of the twentieth century, with the rise of a new, more rigorous form of empiricism (commonly known as 'logical positivism'), rationalism came under serious, unrelenting criticism. The positivists, including Bertrand Russell (1872–1970) and the early Ludwig Wittgenstein (1889–1951) argued that all *a priori* propositions are meaningless in so far as they are not truths about the world, but about a 'reality' beyond all possible sense-experience. Unless propositions could be translated into 'observation statements' that one knows how to verify experimentally or observationally, such propositions must be discarded as metaphysical illusions. Although the propositions of logic and mathematics are independent of experience, these propositions are truths by definition, in accordance with the meanings of the symbols involved.

But it was not long before logical positivism itself came under attack. A key point of criticism was the philosophical status of the claim that only statements which can be verified are meaningful. For how does one verify the claim that only verifiable principles are valid? The empirical criterion of truth is not itself a factual statement, so it seems clear that it is a metaphysical assumption, as abstract or general as the rationalist concepts of 'substance' and 'causation'. An additional problem encountered by logical positivism is that, in the higher levels of science, structures and entities are discussed that are not in any way directly testable against experience, but are really theoretical or universal constructs.

With the decline of positivism (or at least the more extreme version of it), rationalism gra-

dually came back into the scene. A central figure in this contemporary revival has been the linguist Noam Chomsky (1928 -). According to Chomsky, all humans are born with an innate knowledge of the principles of universal grammar. The role of experience is merely to activate the abstract linguistic structure genetically programmed in the brains of humans. He argues that the child's awareness of the principles of universal grammar is *a priori*, rather than acquired through the habitual repetition of words. It would be a mistake, however, to conclude that Chomsky's rationalism excludes empirical research, since his theory is set up as an empirical hypothesis to be evaluated according to the evidence collected on the ways in which children actually learn language, as well as on the evidence about the physiological structure of the brain. Chomsky's linguistics, then, offers us an excellent bridge between rationalism and empiricism.

See also:

rationality; realism

Further reading

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RICARDO DUCHESNE

RATIONALIST CONCEPTION OF

ACTION *see* post-rationalist international political economy

rationality

The assumption of rationality states that actors have clearly defined goals and pursue these goals to the best of their ability, given the information at hand. This assumption has been questioned for a variety of reasons; nevertheless, if properly implemented, rational actor theory can bring precision to informal arguments and serve as the basis for testable predictions. Furthermore, arguments assuming rational actors, often using the tools of GAME THEORY, have become central to the study of international political economy (IPE).

Definitions

Behind the notion of rationality lie a number of assumptions about individuals and their behaviour. First, individuals within the rational actor framework are seen as unitary actors. When a theory examines interactions among NATION-STATES, for example, each state within the system is assumed to act as if it were a single individual, pursuing a clearly identified set of goals. This premise may apply most directly to states with a single leader (such as dictatorships) or to those with a small number of leaders who work in unison. However, it may apply equally well to states with more sophisticated governing structures, including legislatures, bureaucracies and a voting public, when these actors can agree on a set of objectives to be achieved. Such a concordance of opinion is often strengthened by a series of delegation relationships, as (for instance) when the public elects representatives to a legislature, who in turn delegate authority to the executive to negotiate international agreements or treaties.

Second, rationality assumes that each actor has a well-defined set of preferences. These preferences are assumed to be complete, meaning that they encompass all possible outcomes. They are also assumed to be consistent, meaning that they can be represented as a rank order from the most-preferred outcome to the least-preferred (possibly with some ties). In addition, preferences are assumed to be fixed, meaning

that they do not change through the course of a given interaction. Such preferences can be summarized by a utility function, which is a numerical representation of actors' preferences. Beyond this, rationality places no further limitations on preferences. Specifically, it makes no assumptions about the objectives or values that shape actors' goals, so that no single set of preferences is more 'rational' than another. States may pursue power, security or leaders' expected future income; all are consistent with rational actor theory. Note also that the requirement of fixed preferences does not mean that players' behaviour will not change during an interaction, for as new information becomes available rational actors may very well perceive more efficacious means of attaining their goals.

Third, rational actors are assumed to pursue their objectives in a purposeful manner, trying to achieve the most-preferred outcome possible within given institutional and informational constraints. In this sense, rational individuals are far-sighted, possibly basing their current actions on what they believe will happen in the future and on what they think other actors will do. This is not to imply, however, that rational actors will never make mistakes, for uncertainty and insufficient information about the intentions of others and about the conditions at hand may result in actions that, in hindsight, were erroneous. Therefore, rational actors are assumed to maximize their prospective expected utility (what they hope to gain), rather than their retrospective actual utility (what they do gain). Likewise, rationality requires only that individuals act in such a way as to be consistent with maximizing their utility. Individuals need not actually perform complex calculations in their head, even if the mathematics of utility-maximization becomes quite complicated; actors may use rules of thumb or common-sense recipes that produce utility-maximizing behaviour.

Debates over the rational actor approach

Application of the rationality assumption to the study of politics is known as RATIONAL

CHOICE theory. This approach represents an effort to reduce the hard reality with which we are confronted to more manageable terms. The perceived advantage of rational choice theory is that it provides a parsimonious way to model observed patterns of behaviour and generate testable predictions about how outcomes change as a function of varying circumstances. As such, it provides a check on informal reasoning by making the assumptions of one's models explicit and by elucidating the conditions under which competing hypotheses should hold.

The description of international relations (IR) as a set of interactions among rational individuals is not without its detractors, however, as three potential fallacies may undermine the rational choice approach. First, it has been argued that rational choice theory fails to place its assumptions in context, making unsustainable claims to universalism. For example, at various times game theory has been offered as an all-encompassing IR theory, without regard to the particular situation at hand, the preferences of the actors or the institutional context within which they interact. Second, the rationality assumption may lead to an oversimplification of the problem. For instance, some authors have argued that states do not act in a rational, unified manner and are better characterized as subsystems in which domestic actors pursue competing goals and interests; thus it is inaccurate to speak of a clearly identifiable most-preferred outcome. Third, and perhaps the most serious intellectual threat to the rational choice approach, is its alleged failure to test its theories empirically. Donald Green and Ian Shapiro (1994), in particular, argue that tests of rational choice theories are bedevilled by *post hoc* theorizing, slippery predictions and a search for confirmatory evidence, rather than applying critical tests to competing hypotheses.

These criticisms contain more than a germ of truth and, at the very least, should be viewed as a cautionary note to practitioner and reader alike, though to a large degree these concerns can be accommodated within the rational actor paradigm. First, universalistic claims are less

common now than they were when the first applications of rational choice theory appeared. Rather than assert that a few simple canonical games, such as the PRISONERS' DILEMMA or ZERO-SUM GAMES, characterize all IR or political phenomena, rational choice models are now typically formulated for specific domains or problems: the preferences of the actors are clearly motivated, available actions and strategies are defined, and the multitude of possible outcomes under differing conditions are derived. Second, if existing rational choice theories are too simplistic for a given problem, then these models can be expanded to incorporate the omitted aspect of reality. For example, the explosion of work on two-level games was motivated by the claim that IPE literature paid too little attention to the domestic constraints that affect international bargaining. Similarly, signalling models have been used to account for the uncertainties and informational asymmetries that afflict the potential for sustained cooperation between states. Finally, more emphasis has recently been placed on the links between theory and empirical work, with rational choice models providing predictions that are subsequently tested against real-world data.

Overall, the rational actor assumption and the approach that has developed around it provide a useful set of techniques and concepts to examine political processes and institutions. Rational choice theory is particularly well suited to disentangling complex phenomena and reducing a problem to its essential features, perhaps uncovering important strategic interactions that had previously been overlooked or taken for granted. But the rational actor approach is not without its drawbacks. Careful attention needs to be paid to the institutional context that defines a set of explicit decision-making or bargaining procedures. Herein lies the greatest benefit and the greatest challenge to the rational actor approach: to understand individuals and their behaviour within the complexity of their own environment.

See also:

collective action; equilibrium theory; paradox(es) of rationality; perfect information; revealed preferences; tit-for-tat strategies

Reference and further reading

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SHARYN O'HALLORAN

raw materials

Technically, 'raw materials' are defined as natural or semi-manufactured materials that are changed in the process of manufacturing. Thus, while iron ore is a raw material in the production of steel, steel is a raw material in the production of automobiles.

Over the years several issues concerning raw materials have arisen. From the perspective of an advanced country, there are two principal questions: (1) On the physical side, what is the importance of raw materials in production and are they becoming scarcer? (2) On the policy side, with substantial foreign dependency, what are the economic and national security implications (see SECURITY, ECONOMIC)? From the perspective of a developing country, there is one question: What are the pros and cons of specializing in the production and trade of raw materials? In the literature on the subject, this final issue is usually treated under the headings

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of COMMODITIES, the NEW INTERNATIONAL ECONOMIC ORDER (NIEO) or Marxian dependency and EXPLOITATION models (see MARX-IAN ECONOMICS).

With regard to the physical issues, since (given the definition above) the production of almost every physical commodity requires raw material inputs to some degree, their importance can not be overstated. Here, concern centres on the potential exhaustion of certain specific raw materials. What is relevant is how crucial they are to a given standard of living. It is here that consideration must be given to efficiency of use; substitutability of capital, labour, energy and aggregate raw material inputs, and in addition substitutability of materials.

The cost share of raw materials in the total cost or GROSS NATIONAL PRODUCT (GNP) is not a good measure of the importance of such inputs. A large share may well be the result of low marginal productivity with abundant use – for example, raw material wastage in the former Soviet Union. Conversely, a small share may well be consistent with a high marginal productivity with resulting low utilization.

Probably the most reliable measure of the change in relative importance and/or scarcity of raw material inputs is their real (relative) prices. These reflect the true marginal productivity. To the extent that there are positive or negative EXTERNALITIES associated with the use of raw material inputs that are not reflected in the market prices, the market prices should be adjusted downwards or upwards as the case may be. Likewise, non-priced common property resources can become relatively more or less important as their relative scarcity values change. Relative importance thus depends on the production technology not only of market commodities, but also of non-market commodities and of their interactions.

Regardless of one's views on the importance of raw materials, countries have certainly acted as if they were vital. From a national security perspective, liberals contend that FREE TRADE is the best (certainly the most efficient) means of securing adequate supplies; a side-benefit of trade is that increased INTERDEPENDENCE will

help assure peace, because the trading nations will have a stake in maintaining stable flows of raw materials and other traded goods. By contrast, realists (see REALISM) maintain that economic interdependence not only fails to promote peace, but in fact heightens the likelihood of war. States concerned about security will dislike dependence, since it means that crucial imported goods could be cut off during a crisis. This problem is particularly acute for imports like oil and raw materials: while they may be only a small percentage of the total import bill, without them most modern economies would collapse. Consequently, states dependent on others for vital goods have an increased incentive to go to war to assure themselves of continued access to their supply.

See also:

Prebisch Singer hypothesis

Further reading

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ROBERT LOONEY

'Reaganomics'

With the United States suffering from low growth and STAGFLATION (simultaneous increases in INFLATION and unemployment), the Reagan administration began its time in office with promises of a supply-side revolution. Lower inflation, lower taxes and a smaller government were going to boost productivity and growth. Relying on the Laffer Curve, cuts in taxes were going to generate increased revenues and help balance the budget.

The specifics of this new economic policy agenda for the country were dubbed 'Reaga-

nomics' and comprised four key elements: (1) a restrictive monetary policy designed to stabilize the value of the dollar and end runaway inflation; (2) a 25 per cent across-the-board tax cut (enacted in the Economic Recovery Tax Act of 1981) designed to spur savings, investment, work and economic efficiency; (3) a promise to increase defence expenditure while balancing the budget through domestic spending restraint, and (4) an agenda to roll back government regulation.

For this far-reaching economic programme to fully succeed, delicate balancing was required. Monetary policy had to be tightened enough to bring down inflation, but not so much as to create severe recession. Taxes had to be cut, but without raising the spectre of vast deficits that would scare the Federal Reserve Board into an excessively restrictive credit policy. Defence had to be expanded, but not so rapidly as to offset the reductions in civilian spending. Regulation had to be cut enough to provide a significant boost to productivity, but without eliminating public support for the reforms.

The rationale of 'Reaganomics' is contained in the theories of SUPPLY-SIDE ECONOMICS. The best way to examine 'Reaganomics' is to simply look at the record: What was done and why? What succeeded? What failed?

With regard to monetary policies, the decision to fight inflation through monetary contraction had actually been taken in October 1979, more than a year before the election. Nevertheless, there had been considerable uncertainty during 1980 as to the Federal Reserve's resolve. The election of the new administration was important in creating credibility for the tight monetary policy (see MONETARY POLICIES). By 1983, inflation was down to 4 per cent (from double digits in the late 1970s), the recession was over and the economy was growing. Deficits were swollen and monetary policy was no longer center stage, but it still played an important role. The Federal Reserve, faced with high fiscal deficits, decided to maintain high real INTEREST RATES and in the process to accept high and fluctuating growth rates in the monetary aggregates.

Real interest rates were, until the end of 1985, high and roughly constant, before declining.

In the area of FISCAL POLICY, tax cuts received most of the attention. These were put in place by the Economic Recovery Act (or less formally Kemp-Roth) of August 1981. Kemp Roth had three main components:

- 1 A cut in personal taxes, coming from decreases in income tax rates phased over three years and from tax breaks on savings. Income tax rates were decreased in three instalments (5 per cent, 10 per cent and 8 per cent) over the following three fiscal years. Other tax breaks were targeted at savings. Of those, the most significant was a \$2,000 income deduction per worker for contributions to an individual retirement account (IRA).
- 2 A cut in business taxes. The main element was an acceleration of depreciation for tax purposes. Assets were grouped in four categories and given write-off periods of three, five, ten and fifteen years. For most assets, this implied much faster write-off and larger depreciation deductions. The rate of investment tax credit was also increased. To a large extent, however, these tax breaks were offset by the increase in real interest rates stemming from the tight monetary policy.
- 3 The indexation of tax brackets and minimum taxable income, the final part, was delayed until 1985. To a large extent, the decrease in inflation made indexation less important.

After Kemp-Roth there was little fiscal policy action until 1986. Some of the decrease in corporate taxation was undone by the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA). Minor adjustments were made in the Deficit Reduction Act of 1984. These were quantitatively much less important.

From 1981 to 1986, the US economy went through three phases. The first was dominated by monetary contraction, the second by fiscal expansion and the third by anticipations of changes in the money-fiscal mix. Until 1982,

'Reaganomics'

the macro-economy was dominated by the effects of monetary policy. Deficits were still not large and the main development was the increase in short real rates of interest. Once financial markets believed that the Federal Reserve was committed to disinflation and thus to high real rates for some time, long real rates also increased.

By 1982, the increase in real interest rates had led to a sharp recession with unemployment reaching nearly 11 per cent by the end of the year. As the increase in real interest rates was not fully matched by foreign central banks, the real actual and expected interest rate differential also led to a sharp dollar appreciation. The recession and the dollar appreciation both contributed to the decrease in inflation from 9.7 per cent in 1981 to 3.8 per cent by 1983.

By the end of 1982, budget deficits had become the dominant macro-economic force. Large deficits were strongly increasing aggregate demand and putting pressure on interest rates. The policy of the Federal Reserve was to only partially accommodate; the policy of foreign central banks was to only partially respond to US interest rates. The result was an increase in US interest rates, a smaller increase in foreign interest rates and further dollar appreciation.

By 1985, it had become clear that a shift in the money-fiscal mix was required and might indeed be forthcoming. Anticipation of a decrease in deficits and the assumption that the Federal Reserve would again partly accommodate any fiscal contraction, this time by a decrease in interest rates, led to a dollar depreciation starting in early 1985. By 1987, signs of an actual shift in the mix became more apparent, with the Gramm-Rudman deficit reduction law pointing towards reduced fiscal deficits.

Freeing the forces of the supply side was the ultimate goal of the Reagan programme. Behind the short-term developments noted above, did shifts in savings, labour supply, investment and productivity growth occur in response to those changes? The 1981 and 1986 tax changes altered the incentives to save and

to supply labour. By decreasing tax rates across the board in 1981 and by reducing top marginal tax rates in 1986, the after-tax return to both savings and labour supply was increased. The 1981 tax changes further increased the return to retirement savings: these initial tax breaks were partially, but not fully, offset by the 1986 tax reform.

It is clear that the retirement plans for which contributions were partly tax deductible have been very successful. The amount contributed to these plans in 1985 was equal to half of personal savings. The aggregate evidence on savings is, however, much less impressive with savings (no matter how defined) not increasing in the 1980s.

Effects on the labour supply were positive but not very large, with one estimate suggesting that the labour supply of married men increased by 0.4 per cent as a result of the 1981 tax changes and another 0.9 per cent as a result of the 1986 tax reform. The figures for married women were slightly higher.

Taxation of business investment was sharply reduced in 1981 and investment was strong during the recovery, despite higher rates of interest. On the other hand, there is evidence that most of the investment during this period took place in sectors not particularly affected by tax reductions.

Data regarding the effect of 'Reaganomics' on productivity is vague. In actuality, labour productivity growth in the non-farm business sector, which had decreased from an average of 2.3 per cent in the 1960s to 1.3 per cent in the 1970s remained at a low 1.2 per cent over the 1980-5 period. This poor performance comes largely from poor productivity growth in the service sector, which experienced little labour productivity improvement in the 1980s.

As the discussion above suggests, assessing 'Reaganomics' is difficult. It is not clear whether its failures were the result of poor policy design or bad luck. What is clear is the fact of painful and often undesired interactions between the individual parts of the Reagan programme, which resulted in disparate results. Monetary restraint was the key to unwinding inflation, as well as precipitating sharp recession. Reces-

sion, in turn, delayed the beneficial effects of the tax cuts on investment and pushed the budget deficit to unprecedented heights. Ironically, it was the enactment of tax cuts unmatched by spending cuts that forced the Federal Reserve into a tighter monetary policy. The subsequent recession caused a serious budgetary imbalance.

The positive effects of 'Reaganomics' are hard to quantify and appear largely to have been changes in attitudes. Although it is speculative, many commentators have credited 'Reaganomics' with a new sense of realism that became evident in business and personal decision-making in the late 1980s. At that time, labour and management appear to have become more cost-conscious. In the public sector, the era of big dams and expensive waterpower projects drew to a close. The reduced flow of grants-in-aid from the federal government led to a change in the expectations of state and local officials, who began once again to look primarily to their own resources.

The legacy of 'Reaganomics' is a fascinating mixture: lower inflation and higher deficits; lower taxes and higher levels of government-spending; less unemployment and bigger trade deficits; fewer strikes and more government jobs; reduced economic regulation and expanded social regulation; the deepest recession in half a century and the longest peacetime recovery ever.

A few numerical comparisons help make the point. Real GROSS DOMESTIC PRODUCT (GDP) declined by 0.5 per cent in 1980 (President Carter's last year in office) and rose 3.9 per cent in 1988 (President Reagan's last year). The consumer price index (CPI) rose 13.5 per cent in 1980 and by 4.1 per cent in 1988. The prime (interest) rate dropped from 15 per cent in 1980 to 9 per cent in 1988. Real median family income rose from \$34,200 in 1980 to \$37,000 in 1988. The unemployment rate declined from 7.0 per cent in 1980 to 5.4 per cent in 1988. On the other hand, the budget deficit rose from \$74 billion in 1980 to \$155 billion in 1988, while the trade deficit rose from \$15 billion to \$129 billion during the same period. And, contrary to widespread belief, the portion of

the population below the poverty line was 13 per cent in both years. One more set of statistics: real national wealth rose from \$11.9 trillion in 1980 to \$14.2 trillion in 1988.

Even these statistics are not conclusive, judging from the partisan political discourse that still occurs in Washington. Republicans look at these numbers and describe the 1980s as an era of prosperity – a decade when the United States reasserted its economic and military might. Democrats, on the other hand, see the Reagan presidency as a period of record budget deficits, economic decline and widening income gaps between rich and poor. To them, the 1980s was a decade of 'discredited supply-side economics'.

IDEOLOGY also prevents a dispassionate assessment of 'Reaganomics'. The political Left tends to argue that the beneficial economic changes in the 1980s – the conquering of inflation, the surge in employment and the sustained economic expansion – had little to do with Reagan's policies, whereas any negative change – the explosion in the budget deficit, the savings and loan crisis, and so forth – was a direct consequence of the failed theology of 'Reaganomics'. Similarly, the Right argues that only the triumphs of Reagan's record deserve attention and that any problems (such as the big budget deficits) were either inconsequential or the fault of the Democrats in Congress.

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ROBERT LOONEY

realism

A very simple definition of the term 'realism' (better known as 'naïve realism') is that it is the belief that the world exists and is there, whether we perceive it or not. The word 'realism', however, has many, often contradictory, meanings. If today the word 'realism' is associated in philosophy with the view that material objects exist independently of our sense-experience, in ancient and medieval times the term actually meant the opposite – namely, that universal ideas like perfect goodness and perfect straightness are in some sense real. This idea of the reality of universals was introduced into philosophy by Plato (c. 427–347 bc). Plato did not deny the sensory reality of particulars like this straight stick or that round coin, but he held that such particulars had no inherent reality except in so far as they partook of the universal concept of perfect straightness and perfect circularity. Particulars were always imperfect and inadequate exemplifications of the universals. If particulars belong in time and space, and are subject to the change and illusion of the temporal world, universals are eternal and unchanging, and have an existence independent of the particulars they exemplify and of the mind considering them.

Through the Middle Ages, philosophers continued to write of the reality of ideas and used the term 'nominalist' to refer to those who argued that universal concepts were mere names without objective reality. Gradually, however, a semantic change took place and the term 'realism' came to be linked with those philosophers who argued that reality is known only through empirical (or sensory) observation. The work of the English philosopher John Locke (1632–1704) is seminal in the elaboration of this empirical form of realism. Although Locke held that there were physical objects existing independently of our sense-experience, he argued that we are only aware of things as they are presented to us through our senses. He divided the qualities of objects into 'primary' and 'secondary' qualities. The primary qualities are those which a thing has in

itself and which can be measured, such as the size, shape or weight of the thing. The secondary qualities are those which are not intrinsic to the thing, but which depend on the nature of our sense-organs, such as our taste or the colour or smell of objects. The object itself does not have any colour or smell, but has only the power to produce in us these sense-experiences. It may be red or blue depending on the light and the condition of the observer. On the other hand, our sense-experience of the primary qualities are such that they 'resemble' the object as it really is: an object is really square and it also looks square.

But Locke's arguments soon met the sharp criticisms of George Berkeley (1685–1753). First, not only colours but shapes and sizes will vary depending on the conditions of the observer. Furthermore, if we say that an object continues to have the same size as before and only appears to change in size when seen from five metres away rather than from one metre away, then the same may be said about the colour: the tree continues to be green, and only looks purplish-grey when seen from far away. Second, how do we know that our sensory-experience of the primary qualities of an object (size or shape) really resemble those qualities in the object itself? If we are acquainted only with our own sensory experiences of the object, how can we compare our experience of the shape or size of the object with its *real* shape or size independent of our sensory experience? Berkeley thus concluded that, since we are only aware of our sensory experiences of objects, we can never claim to know the objective world as it is in itself. We only know the world as it appears to our senses. This conclusion was to become one of the main tenets of the logical positivist programme, which flourished in the 1920s and 1930s, turning empiricism against realism and proclaiming that any statement referring to some reality underlying our sensory experiences was unscientific 'metaphysics'.

In response to the positivist critique, new forms of realism emerged in the twentieth century. One form, which developed in the philosophy of science and which we might call

'scientific realism', insists that an object has an objective existence which is in no way dependent on our sensory or mental capacities. According to scientific realists, a well-tested theory really explains aspects of the world that exist independent of our sensory experiences and our theorizing about them, and about which the theory is approximately true. There is no unbridgeable gap between our sensory experiences and reality. Empirical observation, together with rational theorizing, are precisely the means by which scientists come to know the real underlying causes of things that are not always apparent to the senses.

Realism is a term also used extensively outside philosophy and science, in literature, poetry and painting, where varieties of realism abound. One of the major literary doctrines of the twentieth century is that of 'socialist realism', of which the Stalinist Soviet form, for example, demanded of the writer an 'objective', historically concrete representation of reality in its movement towards socialism. Paradoxically enough, however, this Stalinist realist tradition gave way to a Platonic form of realism, as reality came to be viewed exclusively in terms of this movement towards the Great Society of the future, above and beyond the everyday lives of common people. This is in stark contrast to the realism one finds in Alexander Solzhenitsyn's novel, *One Day in the Life of Ivan Denisovich* (1962), which is filled with minute detail on every circumstance or experience during a single day in the life of a prisoner in a Soviet labour camp.

Perhaps the best-known version of realism is the doctrine of *realpolitik* of the Kissinger/Morgenthau variety, according to which hard-headed practicality is required by political actors in a world in which the primary goal of every NATION-STATE is to promote and defend the 'national interest'. This *realpolitik* tradition has its intellectual source in the writings on power of THOMAS HOBBS (1588–1679). Hobbes argued that INTERNATIONAL RELATIONS (IR) were like those in the 'state of nature', since each state, as a sovereign entity, is at liberty to pursue its own interests as it sees fit, unimpeded by any higher authority

or power. This realist tradition, therefore, conceives IR as chaotic in character, since the ultimate arbiter within the international system are rational, egoistic nation-states pursuing their own interests (see RATIONALITY).

But while this *realpolitik* tradition has dominated international studies, there is an influential WORLD-SYSTEMS THEORY, including similar neo-Marxist approaches (see NEO-MARXISM), which looks at the real constraints of world CAPITALISM on agents' choices. Unlike the *realpolitik* school, this neo-Marxist approach emphasizes the enmeshment of individual states within the wider capitalist global order and the way the real logic of capital accumulation conditions the behaviour of individual states.

According to neo-Marxist realists, the spread of MULTINATIONAL CORPORATIONS (MNCs) and the GLOBALIZATION of production and capital, require a new conception of IR based on transnational economic practices. This transnational capital order is a real structure which both limits the autonomy of states and diminishes their sovereignty. Not only do multinationals organize their production, marketing and distribution on a global basis, but the largest ones have assets and annual sales far larger than the GROSS NATIONAL PRODUCT (GNP) of almost any of the countries in the world. As capital loses its national distinctiveness and establishes its dominion on a supranational level, most of the variables determining national policy move beyond the control of national governments. The monetary and fiscal policies of national governments (see FISCAL POLICY; MONETARY POLICIES) are increasingly dominated by movements in the international financial markets, and must to a large degree be compatible with the regional and global movements of capital. The levels of employment, investment and revenue within a country increasingly depend on the decisions of multinationals about the location of their facilities. This raises a fundamental question about the nature of democratic participation in the face of an international economic order structured by corporate organizations over which citizens have very little control.

reciprocity

See also:

capital, internationalization of; cosmopolitan values; Cox, Robert W(arburton); Gilpin, Robert; governance, global; international political economy (IPE); neo-realism; philosophical realism

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RICARDO DUCHESNE

REALIST PHILOSOPHY *see* philosophical realism

reciprocity

'Reciprocity' refers to a mutual exchange that the parties regard as fair. In trade, reciprocity has meant an approximate equality of concessions granted and trade benefits received among or between parties in a negotiation. Trade reciprocity has connoted, at various times, retaliation for unfair trade practices, LIBERALIZATION through equivalent concessions or equal access to markets. Unlike FREE TRADE, reciprocity means that a state grants another country's products access to its market only if the state makes an equivalent trade concession. Because reciprocity implies that an increase in a state's imports is balanced by an expansion of its exports, domestic public opinion prefers reciprocal trade agreements to unconditional free trade. Reciprocity was used in the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) to promote trade liberalization by means of the MOST-FAVOURLED-NATION principle, whereby any concession granted to the principal supplier automatically applied to all other trading partners. Since the 1970s, proponents of reciprocity in the United States have gone beyond asking for equivalent concessions in negotiations to demanding equal access to overseas markets.

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DEBORAH WELCH LARSON

REDISTRIBUTION WITH GROWTH

see development

re-exports

'Re-exports' are goods that have been sold to a party in a foreign country who, after making

little or no modifications to the goods, sells them to a party in a third country. Re-exports can be problematic if they ultimately arrive at a destination forbidden by the policies or regulations of the country where the goods originated. For example, prior to the LIBERALIZATION of trade between the United States and Vietnam, US computers and other goods were frequently re-exported by European and Asian companies to the Vietnamese consumers. US goods were thus available in Vietnam before US companies were allowed to conduct business there.

GEORGE E. SHAMBAUGH

reflexive modernization

Within sociology, the concept of 'reflexive modernization' has emerged as a key point of reference in a series of controversies – some particular to the field, others with import far beyond it. Modernization is a familiar concept to scholars of POLITICAL ECONOMY. Reflexivity refers in a broad way to the emergence of new and critical forms of consciousness, in both groups and individuals. Introduced first by Ulrich Beck and developed by Anthony Giddens and others, the combination of these concepts is used in two senses: (1) as an organizing concept capturing a moment in modernity's development and (2) as a diagnosis of the material conditions of late CAPITALISM.

In terms of the first – reflexive modernization as a historical moment – the key argument is that modernization has turned bad, producing more social risks than goods. As these risks become increasingly obvious (acid rain, ozone depletion, nuclear waste and so on) new forms of social critique emerge (ecologism, anti-scientism, critiques of technology and progress, and so on), in turn transforming the basis of capital production and giving rise to new forms of individuality and collective identity. Rather than viewing these developments as indicative of either a structural crisis or a social revolution, theorists of reflexive modernization point to new forms of social

learning emerging *within* modernity. In doing so, they place their analysis of modernity and modernization between two extremes: that of Jurgen Habermas, KARL MARX and the utopians, on one hand, and that of Theodore Adorno, MAX WEBER and the *nouveaux philosophes* on the other. Reflexive modernization is the process by which the hazards of modern systems of life and production are dealt with through a *radicalization* of modernity itself (reflexivity). Not so much a post-modern age, then, as the modernization of the principles of industrial society.

In terms of the second use of the term – reflexive modernization as a diagnosis of late capitalism – the essence of the argument concerns the shift from rigid production systems to flexible ones of DISORGANIZED CAPITALISM (the transition from Fordism to POST-FORDISM, in other words). Knowledge becomes ever more important as advances in communications and transport shrink the size of the planet, speeding up production and bringing both the competitor and the consumer closer to the producer. In *Economies of Signs and Space* (1993), Scott Lash and John Urry go furthest in analysing the implications for political economy of this move to knowledge-based industry. Focusing on the complex interplay of a series of transformations commonly grouped under the banner of GLOBALIZATION (including the internationalization of finance, the dissolution of the corporate-liberal synthesis, DEINDUSTRIALIZATION, and the absolute and relative decline of the working class – see CLASS, WORKING), Lash and Urry put forward the notion of 'reflexive accumulation' as the best description of the decoded systems of late capital. To this they add sociological analyses of the commodification of leisure and lifestyle (what they call 'reflexive consumption'), increasing migration and tourism, the ever-increasing importance of cultural signs and artefacts (fashion, ADVERTISING and so on), as well as changes in family structures and what they call, following Giddens, 'detraditionalization' – in all, building a powerful sociology of contemporary global change.

refugees

See also:

time-space compression

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IAN ROBERT DOUGLAS

refugees

In the 1990s, the number of refugees worldwide reached unprecedented levels. It exceeded 20 million every year after 1990, peaking in 1995 with 26.1 million. Another 20 million people are 'internally displaced' or in 'refugee-like' situations. Four-fifths of these people are women and children. The largest numbers are found in Africa (the Horn, the area around the Great Lakes, West Africa), Europe (Bosnia and the former Soviet Union), the Middle East (Palestinians), Central Asia (Iraqis and Afghans) and Thailand (from Cambodia and Myanmar). Approximately 15 per cent of all refugees are in the industrialized states in Western Europe and North America.

In everyday language, the term 'refugee' refers to any person trying to escape persecution, violence, environmental disaster or poverty. The Universal Declaration of Human Rights (1948) bestows on every human being 'the right to seek and to enjoy in other

countries asylum from persecution' (Article 14). In the GENEVA CONVENTION, the use of 'refugee' is restricted to those people who have fled their home country because of a well-founded fear of persecution because of political or religious conviction or membership of an oppressed ethnic or social group. Asylum-seekers are those individuals claiming to be refugees and awaiting a decision on their asylum request.

The modern world has known several episodes of major refugee flows: those following the Reformation and Counter-Reformation in Europe in the sixteenth and seventeenth centuries, the American and French Revolutions at the end of the eighteenth century, the dissolution of the Russian, Austro-Hungarian and Ottoman Empires after World War I, the terror of Nazism and Stalinism in the 1930s and 1940s, and the DECOLONIZATIONS and social revolutions in the THIRD WORLD between 1947 and 1965. However different the immediate events leading up to specific refugee flows were, all of these flows were fundamentally connected either with the formation of new states and the separation of populations in the process ('ethnic cleansing') and/or with social revolutions.

The refugee flows of the 1980s and 1990s are partly the product of similar developments (the dissolution of the Soviet Union, the break-up of Yugoslavia, the belated decolonization in Southern Africa). However, since the mid-1970s a new factor in play has been the impact of the world economic crisis, especially of the DEBT CRISIS, on political and social stability in many regions around the world, causing the exacerbation of social, religious and ethnic conflicts and ultimately the total collapse of many states.

See also:

migration, international

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HENK OVERBEEK

regime of accumulation (ROA)

The notion of a 'regime of accumulation' (ROA) emanates from the Regulation School of political economy, and first came to the attention of English readers in Michel Aglietta's *A Theory of Capitalist Regulation* (1979). The ROA represents an organizing principle around which Aglietta explains the rise and demise of successive phases of capitalist reproduction. It was introduced in order to examine accumulation within a historically specific framework, linking the technical RELATIONS OF PRODUCTION with the institutions underlying production, distribution and exchange. Such a linkage was innovative because it provided a rich foundation for examining the production of SURPLUS VALUE and the institutional forms involved in the realization of surplus value within an extended circuit of social capital.

Extensive regime

Aglietta differentiates between two main ROAs in the relatively mature history of capitalism (especially for the United States): extensive and intensive. The extensive ROA was the dominant accumulation regime characteristic of the industrial phase of capitalism, especially from the 1870s to the 1920s. This is associated with the advent of large-scale industry, ECONOMIES OF SCALE, reorganization of the labour process and the gradual deepening of TAYLORISM. It was 'based on the build-up of heavy industry', utilizing steel and electricity, especially with a view to the development of 'mining resources, waterways and railway junctions' (Aglietta,

1979: 79, 84). Taylorism was important for this regime as

the sum total of those relations of production internal to the labor process that tend to accelerate the completion of the mechanical cycle of movements on the job and to fill the gaps in the working day [which] ... came into force in the engineering industries at the end of the 19th century.

(ibid.: 114)

In analysing regimes, Aglietta adopted a two-sector model, with capital goods as the first sector and consumer goods as the second. The extensive regime was subject to UNEVEN DEVELOPMENT between the two sectors, with the tendency of the capital goods sector to grow faster than the consumer goods sector. A major limit of the extensive regime was effective demand, since profitability depended heavily on absolute surplus value (for instance, the length of the working day), and therefore wages and workers' conditions were restricted. When uneven development between sectors became pronounced, a crisis tended to occur (recessions and depressions). The GREAT DEPRESSION of the 1930s was the greatest crisis, precipitated by uneven development between the two sectors. Insufficient markets and thus a lack of effective demand became the main structural limit of the extensive regime; this limit severely curtailed the further extension of capitalist technical and social relations (ibid.: 107).

Intensive regime

By the 1930s, the extensive regime had already evolved considerably. Taylorism had become deepened through the development of Fordism and the embryonic foundation of a new regime of production was well under way. Fordism was essentially the basis for the new 'intensive' regime of accumulation, which had two main aspects. One was associated with the technical and social relations of production. This included the semi-automatic assembly-line production system, which was designed to produce

regime of accumulation (ROA)

long production runs particularly of consumer goods. Also,

Fordism further developed the mechanization of labor, increased the intensity of work, radicalized the separation between manual and mental labor, [and] rigorously subjected workers to the law of accumulation through the 'mechanization of labor'.

(ibid.: 117–18)

Fordism deepened Taylorism by integrating the different parts of the labour process through conveyors and other devices, and by subjecting workers more specifically to the motion of the machine process and thereby limiting autonomy.

The other aspect of the new intensive ROA was associated with the transformation of the conditions underlying the reproduction of wage labour. During the twentieth century, workers gained more rights and New Deal-style governments arose in most advanced capitalist economies, while after World War II a new social mode of organization of capitalism arose. Central to these developments was an expansion of the norm of consumption for workers and rising wages. In the 1950s and 1960s, household stability, 'suburban bliss' and mass consumption of consumer durables provided the basis for expanded reproduction of capital. The central commodities upon which this was based were housing, televisions, motor vehicles, refrigerators and electrical appliances. Keynesian policy and full employment were important to the expansion of mass consumption (see KEYNESIAN ECONOMICS).

This intensive regime in large measure solved the problems of inadequate markets and uneven development through the relatively balanced dual expansion of capital and consumer goods sectors (see Jonsson, 1993). Business cycles still operated in the 1950s and 1960s, but the onset of deep recessions and depression due to limited markets appeared to be a thing of the past. The long boom of capitalism along the lines of the (Fordist) intensive ROA was a common feature of most advanced capitalist economies. Institutional features which enabled accumulation to expand

included the supply of credit from the financial system, a system of FIXED EXCHANGE RATES and international hegemony, plus the Keynesian policies and household stability already mentioned.

However, every regime of accumulation has its limits or barriers. Eventually the contradictions of the intensive regime became manifested, leading to the development of extensive socioeconomic crises and further metamorphosis from the 1970s to the 1990s. The major contradiction emanated from the very systems of production and distribution associated with the intensive regime. On one hand, in the late 1960s and 1970s workers rebelled against the repressive system of production, leading to more strikes and challenges to the system of control. On the other hand, workers gained more power over distribution as the policies of full employment led to a higher wage share of national income. These challenges to capital in the spheres of production and distribution led to lower rates of accumulation and hence much of the anomalous economic performance of advanced capitalist economies in the 1970s and 1980s (see O'Hara, 1994).

A new regime?

Like every period of systemic crisis, the 1970s to 1990s (probably continuing into the early years of the twenty-first century) represent an era of metamorphosis, during which the old regime gradually gives rise to a new regime (see Tylecote, 1992). However, the process of emergence of the new regime is at times tentative and evolutionary. Indications are that the new regime may be associated with flexible production or a flexible ROA. Under this regime, the dominant characteristics of production are just-in-time production, total quality management and some limited degree of worker-participation and teamwork. The resolution of effective demand seems to be dependent on exports through the world market. The effective demand aspect, at least at this stage, appears to be especially fragile from the perspective of sustained expansion.

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regime theory

Regime theory arose in the 1970s, and gained momentum during the 1980s, as a response partly to the intellectual challenge posed by the study of social dilemmas or COLLECTIVE ACTION problems and partly to the political challenge associated with the apparent decline in the ability of the United States to function as a dominant actor in international society. The appeal of the theory stems, in large measure, from the fact that it proposes a solution to a critical puzzle: How is it possible for utility-maximizing actors to cooperate effectively under conditions of interactive decision-making where there are incentives to cheat but no central political authority of the sort we would normally think of as a government? What emerges is a vision of GOVERNANCE without government, in which the failure to create a world government to take up the slack left by the erosion of US dominance need not be regarded as a cause for serious concern among those who think about issues of governance in international society.

The problematique of regime theory can be stated in simple terms. States, treated as unitary utility-maximizers, engage in interactive

decision-making in which there are mutual benefits to be derived from cooperation, but in which there are also incentives for individual participants to defect or (in other words) to choose non-cooperative strategies. In the most severe cases – exemplified by the PRISONERS' DILEMMA – defection is a dominant strategy for each of the players, despite the fact that mutual cooperation would yield better pay-offs for all of the participants. Under real-world conditions, however, states – like individuals who participate in laboratory experiments involving collective-action problems – succeed in arriving at cooperative outcomes some of the time, even though they also fail to cooperate with considerable frequency. The research puzzle, then, centres on a search for factors that explain this variance or – to put it another way – the determinants of cooperation under conditions of strategic interaction.

Regime theory suggests that states succeed in cooperating when (and to the extent that) they are able to form institutional arrangements or sets of roles, rules and relationships of the sort we have come to think of as international regimes. But this proposition does not solve the puzzle; it simply leads to a second-order question: How can we explain successes and failures on the part of groups of states that seek to solve collective-action problems through the formation of international regimes? The core of regime theory consists of an effort to answer this question in a convincing manner. The most influential answers are often grouped, for shorthand purposes, into three broad categories labelled 'power', 'interests' and 'knowledge'. A fourth (albeit somewhat different) answer highlights what has come to be known as the 'evolution of cooperation'.

In brief, those who emphasize the role of power argue that regimes form when a dominant actor – known in this line of analysis as a 'hegemon' (see HEGEMONY) – chooses to exert its influence to induce others to agree to the provisions of a constitutional contract that sets forth the basic features of a regime. Analysts whose thinking features interests, by contrast, see regime formation as a bargaining

process and expect regimes to form whenever a contract-zone exists and the benefits likely to flow from striking a bargain exceed the transaction costs associated with the bargaining process. For their part, commentators who see knowledge as a key determinant of success generally stress the role of discourses in guiding the process of regime formation; some go a step further, highlighting the contributions of EPISTEMIC COMMUNITIES or groups of experts who share both a diagnosis of the problem to be solved and a proposed solution, and who act as influential advocates of specific responses to collective-action problems. Finally, there are those who take their cue from the earlier work of FRIEDRICH VON HAYEK on self-generating arrangements. They argue that regimes can arise spontaneously in on-going relationships where the shadow of the future is substantial.

Each of these answers sheds light on the process of regime formation, at least in some cases. Whether considered on their individual merits or taken as an interconnected set of propositions, however, these arguments do not add up to a satisfactory theory of regime formation. This is partially attributable to the facts that the resultant propositions are often set forth in forms that are untestable and that specific propositions flowing from these lines of analysis frequently conflict with one another. Many arguments about the role of power, to start with a prominent example, suffer from an inability to determine in advance whether any of the parties qualifies as a hegemon. Much the same can be said about efforts to document the existence of epistemic communities in a clear and unambiguous fashion. For their part, those who believe self-interested actors can be counted on to strike bargains without any outside pressure are apt to see no need for the efforts of a dominant power or an epistemic community to ensure that negotiations reach successful outcomes. By definition, spontaneous processes do not depend on active efforts on the part of hegemonies or epistemic communities, though it may be that individual actors in such situations follow institutional leaders – much like indi-

vidual citizens follow opinion leaders in deciding how to vote.

Equally important, these efforts to account for successes and failures in efforts to form regimes do not fare well when tested against evidence drawn from real-world cases. It is easy to find regimes that have formed in the absence of a dominant actor; there are even cases in which the most powerful member of the group emerges as a laggard that has to be cajoled, harassed or coerced into accepting the regime. Regimes commonly form in the absence of consensual knowledge, much less an epistemic community promoting a coherent solution to a well-defined problem. Although it may later come back to haunt those responsible for administering regimes, some differences in thinking about the nature of the problem may even facilitate the process of regime formation. Many cases of regime formation are difficult to explain in terms of mainstream approaches to bargaining, even though activities that are easily interpretable as negotiations are commonplace. While spontaneous processes in such forms as tacit bargaining are undoubtedly widespread, moreover, most cases of regime formation in international society are characterized by self-conscious interactions eventuating in explicit agreements that take such forms as conventions, treaties and ministerial declarations.

Under the circumstances, it should come as no surprise that students of international regimes have sought to expand their research agenda, asking questions in the first instance about new ways to approach regimes and regime formation, and moving on from there to redefine the basic research puzzle animating regime theory in such a way as to transcend its initial preoccupation with regime formation. Turning first to efforts to redirect the study of regime formation, four sets of concerns seem particularly prominent: the nature of the actors, institutional bargaining, problem structure and stages of regime formation.

By concentrating on states treated as unitary actors that seek to maximize absolute gains, the core of regime theory has limited itself to a restricted and rather stylized set of cases. In reality, many of the most interesting insights

about the creation of regimes come into focus as a result of the relaxation of one or another of these assumptions about the actors involved. Thus states engaged in processes of regime formation typically find themselves forced to make decisions under uncertainty, a fact that stretches standard ideas about utility-maximizing behaviour and makes it interesting to think about phenomena like exploratory bargaining and social learning. Issues pertaining to international regimes also play into policy debates within states, so that what have become known as two-level games loom large in efforts to understand the processes through which many international regimes are formed. What is more, we are now aware that non-state actors can and often do become important players in connection with the formation of individual regimes. As those who have studied commodity chains, international CARTELS and informal arrangements covering services like insurance have pointed out, there are even cases of regimes in which states are not the principal players.

Whatever the character of the actors, efforts to form international regimes regularly feature negotiations aimed at reaching agreement on the provisions of constitutional contracts. Yet the resultant process of institutional bargaining differs in striking ways from the processes envisioned in most formal models of bargaining. Participants in institutional bargaining seldom know the locus of the contract curve or the negotiation set, a fact that typically leads to a lively interest in integrative bargaining in contrast to distributive bargaining and to the use of negotiating texts as vehicles for forging agreement on the provisions of ongoing institutional arrangements. When bargaining of this type involves n -person interactions – as it often does – the participants are more apt to seek to form coalitions of the whole than the minimum winning coalitions that game-theoretic analyses often single out for special attention. In effect, institutional bargaining – in contrast to legislative bargaining – places a premium on persuading all members of the relevant group to accept the provisions of a constitutional contract. Under these condi-

tions, crises or exogenous shocks can make a difference in energizing processes of regime formation. Similarly, leadership on the part of key individuals frequently emerges as an important determinant of success in efforts to induce all the major players or negotiating blocs both to accept international agreements that set forth the terms of regimes and to take the steps necessary to transform them from paper to practice.

Although regime formation is nearly always interpretable as an exercise in problem-solving, not all problems that stimulate efforts to create regimes are alike. To put it simply, some collective-action problems are more difficult to solve than others. An implicit awareness of this fact underlies early contributions to regime theory that differentiated between coordination problems, which have stable – though often asymmetrical – equilibria, and collaboration problems, which leave individual participants with incentives to cheat. Yet subsequent efforts to devise a generic index that would allow us to rate individual problems on a continuum from easy-to-solve to difficult-to-solve have so far yielded rather meagre results.

Yet another important observation arising from empirical studies of regime formation concerns the division of the overall process into stages that differ from one another in important ways. More often than not, the central phase of the process features organized negotiations. But this phase is ordinarily bracketed by stages that centre on activities involving agenda formation on one hand and operationalization on the other. The fact is that international agendas – like their domestic counterparts – are perennially congested, so that it is important to understand why and how particular problems make their way onto these agendas, take shape as policy issues and rise to high enough levels on the relevant agendas to justify the expenditure of resources required to mount a successful effort to form a new regime. Similarly, the fact that many agreements degenerate into dead letters or develop into practices that differ more or less dramatically from the arrangements described in founding documents makes it important to examine the

factors that govern efforts to operationalize the provisions of regimes as set forth in the agreements worked out during the negotiation stage. For those seeking to understand successes and failures in efforts to form international regimes, the significance of dividing the overall process into stages arises from the fact that the individual stages have political dynamics of their own, which cannot be captured in a single model of regime formation.

More generally, it is now apparent that regime formation is not an end in itself. Here, too, the research puzzle that has guided work on international regimes has proven somewhat misleading. In a highly structured situation, like prisoners' dilemma, it is reasonable to suppose that when all the participants choose the cooperative strategy, the problem will be solved and the mutual gains will accrue to the players without further action on their part. In real-world situations, by contrast, there is a clear distinction between forming regimes and solving problems. Agreements codified in formal documents may reflect an inappropriate understanding of the problem, degenerate into dead letters, get implemented in a fashion that distorts some of their key provisions, or be swamped by pressure arising from other concerns crowding international agendas. It is not surprising, under the circumstances, that students of international regimes have become increasingly interested in what happens to regimes following their initial establishment. Among the themes that have emerged from this shift in perspective, four seem particularly important to the future of regime theory: effectiveness, institutional change, institutional interplay and links to international society.

In the final analysis, effectiveness is a matter of the extent to which the operation of a regime serves to solve the problem that led to its formation in the first place. Because problem-solving turns out to be a difficult concept to operationalize, students of international regimes often supplement this concern with a sustained effort to trace the impacts of regimes on the behaviour of their members and – through the efforts of members – of those whose actions are responsible for the problem

that needs to be solved. In either case, it is apparent that effectiveness is a variable. One regime may be more effective than another; the effectiveness of a single regime may vary over time, and the same regime may affect the behaviour of some actors more than others. Arguments that approach the issue of effectiveness in dichotomous or all-or-nothing terms are therefore of little interest. The central problem arising in analyses of effectiveness involves demonstrating the causal links between regimes on one hand and problem-solving or behavioural change on the other. How is it possible to avoid exaggerating the effectiveness of regimes as a result of spurious correlations or underestimating the effectiveness of regimes in cases involving masked or lagged impacts? There are no simple solutions to these analytic difficulties. But it now seems clear that one of the keys to understanding effectiveness lies in studies of the mechanisms or pathways through which regimes influence the behaviour of those actors who are subject to their rules, are involved in their decision-making procedures or are beneficiaries of their programmes. In a very real sense, the centre of gravity of regime theory has shifted from the study of regime formation as such, to an effort to explain why some regimes are more successful than others in coping with the problems that lead to their establishment.

The recasting of the research puzzle to differentiate between regime formation and regime effectiveness, and to highlight the search for determinants of effectiveness, has also drawn attention to the fact that regimes are dynamic arrangements that change continuously in response to both endogenous and exogenous forces. Despite the obvious temptation to do so, relying on some form of life-cycle analysis as a way to structure thinking about institutional change does not seem like a good idea. Regimes often do evolve over time into increasingly complex structures. Yet there is no basis for equating complexity with maturity and many regimes remain in place on an indefinite basis. The study of regime change can be approached from several distinct angles. There are, to begin with, questions about

patterns of change and the forces that energize different types of change. Borrowing a concept developed by ecologists, on the other hand, it is possible to approach this subject as a matter of resilience and to ask questions about the factors that determine the capacity of regimes to withstand various types of change without breaking down or undergoing a radical shift from one state to another. At present, the study of regime change is just coming into focus as an analytic priority among those engaged in research on international institutions. Yet it is clear already that a comprehensive theory of international regimes must come to terms with the fact that regimes are highly dynamic arrangements and provide tools for thinking about what happens to individual regimes following the initial act of creation.

Another issue that surfaces once the initial preoccupation with regime formation is set aside involves what analysts have begun to describe as institutional interplay. Although those who are knowledgeable about specific regimes have often viewed them as self-contained or stand-alone arrangements, it is apparent that most regimes interact extensively with a variety of other institutions. It is helpful, in this connection, to start by drawing a distinction between horizontal interplay and vertical interplay. Horizontal interplay occurs in situations where individual regimes interact with other institutional arrangements in international society. There is a rapidly growing stream of analysis, for instance, that examines issues involving interplay between environmental regimes containing provisions pertaining to trade (for example, the ozone-protection regime, the regime governing transboundary movements of hazardous wastes, the regime regulating trade in endangered species) and the overarching GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)/WORLD TRADE ORGANIZATION (WTO) system covering international trade in goods and services. Vertical interplay, by contrast, involves interactions between international regimes and domestic arrangements dealing with similar concerns within individual member-states. Interest is growing, for example, in the compatibility of interna-

tional arrangements like the regime dealing with long-range transboundary air pollution and the regulatory arrangements that individual countries have created to deal with problems of acid rain at the domestic level. Concerns of this sort underlie the rapid growth of interest among students of international regimes in a broad range of questions concerning efforts to implement the provisions of specific arrangements.

The realization that individual regimes co-exist and typically interact with a range of institutional arrangements operating in other ISSUE AREAS has added an important new dimension to the research programme of regime theory. But this development has not dispelled the impression arising from regime theory's original research puzzle that these arrangements operate in a kind of social vacuum. As it turns out, individual regimes operate within the larger setting provided by international society, a fact that has far-reaching consequences both for the effectiveness of regimes in solving specific problems and for the broader consequences flowing from activities undertaken in connection with individual regimes. Recognized early on in ideas like John Ruggie's concept of 'embedded liberalism', these concerns fell by the wayside in efforts to formulate specific propositions about the determinants of regime formation. A sustained analysis of the links between regimes and the broader social setting within which they operate is destined to become a growth area in regime theory.

See also:

cooperation; global warming (UN Climate Convention)

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regional development banks (RDBs)

Established with the ostensible purpose of promoting economic development, the regional development banks (RDBs) have been key features of the post-World War II world economy. The largest RDBs are the ASIAN DEVELOPMENT BANK (ADB), AFRICAN DEVELOPMENT BANK (AfDB), EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD) and the INTER-AMERICAN DEVELOPMENT BANK (IDB). These institutions employ WEIGHTED VOTING, use special majorities and defer day-to-day decision-making to a subset of members. Votes are weighted roughly on the basis of capital contributions. Attention is also paid to whether a country is a regional or non-regional member. In order to grant a voice to every member – regardless of its capital contribution – all members receive a base number of votes. In addition to simple majorities, decisions are made using various types of special majorities, such as 70 per cent. While their Board of Governors formally manage each RDB, a smaller organ – a Board of Directors – makes most decisions. Most large contributors (for example, the United States) appoint their representative to the Board of Directors in each RDB. The majority of members are aggregated into 'voting groups'. Each voting group elects one member to represent the group, including casting all the votes available to members of that group. The combination of weighted voting, special majorities and the constituencies has been shown in

some studies to diminish the influence of smaller (usually regional) members.

See also:

African Development Bank (AfDB); Asian Development Bank (ADB); European Bank for Reconstruction and Development (EBRD); Inter-American Development Bank (IDB); weighted voting

JONATHAN R. STRAND

Regional Economic Development Working Group (REDWG)

The Regional Economic Development Working Group (REDWG) was one of the five Arab-Israeli multilateral working groups created by the Madrid peace conference of November 1991. The activities of the working group are coordinated by the EUROPEAN UNION (EU) (which acts as the gavel-holder for the working group) and its membership comprises four of the core regional parties to the Arab-Israeli conflict – Israel, Egypt, Jordan and the Palestinian Authority, together with a range of countries from the Arab world and international community. Syria and Lebanon, however, have boycotted all the meetings and related activities of REDWG. The role of REDWG is to support the Middle East peace process by helping foster the conditions for and promoting regional economic cooperation. It has concentrated its activities in particular in four areas: finance, trade, infrastructure and tourism. In March 1995, the REDWG secretariat was established to service the activities of the working group. Based in Amman, Jordan, and staffed by personnel from Israel, Egypt, Jordan and Palestine, it was the first and remains the sole functioning regional institution spawned by the Middle East peace process.

JOEL PETERS

regionalism

Regional economic arrangements have long been important features of the international political economy. During the period after World War II, however, these arrangements have become especially pervasive. The EUROPEAN COAL AND STEEL COMMUNITY (ECSC) was formed in 1951 and, within the next decade, the EUROPEAN ECONOMIC COMMUNITY (EEC), the EUROPEAN FREE TRADE ASSOCIATION (EFTA) and the COUNCIL FOR MUTUAL ECONOMIC ASSISTANCE (CMEA) came into being. Soon thereafter a wide variety of regional economic arrangements were concluded among LESS-DEVELOPED COUNTRIES (LDCs), particularly in Africa and Latin America. These events spurred considerable interest on the part of scholars and policy-makers in the factors that contribute to regionalism and its political and economic consequences. But many regional economic arrangements – especially those involving developing countries – failed to accomplish their stated purposes and interest in regionalism subsequently waned. Recently, however, social scientists have devoted increasing attention to this topic. The advent of the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), the ongoing process of economic integration in Europe, the formation of MERCOSUR and the possibility of a Pacific economic bloc have led once again to lively and widespread debate concerning the causes and effects of regionalism.

Defining regions and regionalism

Although regionalism has been studied extensively, considerable disagreement continues to exist about its definition. Some scholars of international political economy (IPE) define a region as a geographically specified area and argue that economic regionalism refers to the disproportionate concentration of economic flows or the coordination of foreign economic policies among a group of countries in that area.

Both political and economic factors have been identified as causes of regionalism, defined in this manner. The geographic concentration of economic activity frequently is viewed as a 'natural' outgrowth of close proximity. Based on this position, for example, states tend to trade more with neighbours than with countries located at a greater distance because transportation costs tend to rise as the distance between trade partners increases. All other things being equal, the lower these costs, the less expensive are foreign goods, thereby increasing local demand for them. In contrast, many observers argue that regionalism is an outgrowth of policy choices by governments. Based on this position, the geographic concentration of economic activity is due to foreign economic policies enacted by states in close proximity to achieve this end. Viewed in this light, the high concentration of trade flows among members of the EUROPEAN COMMUNITY (EC) and EUROPEAN UNION (EU), for example, has occurred because of an explicit agreement to reduce trade barriers on members' goods and impose a common set of trade barriers on those of non-members.

While many analyses of regionalism define regions in geographical terms, others do not. Like studies that define regionalism with reference to geographical proximity, studies of this sort often consider regionalism to be a product of government policies. Some scholars argue that a group of countries collectively relying on a single member's currency constitutes a regional currency area, even if these countries are not located in close proximity. In addition, numerous studies of regionalism focus on preferential trading arrangements (PTAs), which are agreements by members to grant commercial concessions to each others' goods. Many PTAs – like the EC/EU and NAFTA – are comprised of members in relatively close geographical proximity. But others – like the United States-Israeli Free Trade Area and the preferential agreements between the EC/EU and various African and Middle Eastern countries – are not. Furthermore, some studies that define regionalism in non-geographical terms view it as an outgrowth

regionalism

of factors other than state policy, including a common culture, language, religion or ethnic background among a group of states that may or may not be located nearby.

Some theories of regionalism

Scholars interested in regionalism often point to potential improvements in the WELFARE of members to explain the formation of regional arrangements. For example, JACOB VINER (1950) and others suggested that a PTA can enhance members' welfare if it creates more trade among efficient producers within the PTA (at the expense of inefficient producers within it) than it diverts from efficient producers outside the PTA (to inefficient producers within it). Further, it has been shown that, in principle, any group of countries can form a PTA with a common external tariff (CET) that improves members' welfare without degrading that of other states, and that incentives exist for the PTA to expand until it includes all countries. In this way, economic regionalism could foster international economic openness. Others, however, have cautioned that if governments consider regional arrangements to be alternatives to multilateral initiatives (like the WTO) to liberalize trade or if these arrangements are designed to protect inefficient producers from foreign competition, they may undermine an open international trading system. Indeed, the extent to which regionalism promotes countries' welfare and international economic LIBERALIZATION remains a matter of considerable controversy among IPE scholars.

Also controversial are the political influences on the formation of regional arrangements. Much work conducted by political scientists on this topic has centred on explaining economic and political integration. This research has tended to stress the importance of economic factors that serve to integrate states by blurring the legal boundaries among them.

Among the most influential approaches to the study of integration are FUNCTIONALISM and NEO-FUNCTIONALISM. Exponents of these approaches posit that governments forge regional institutions to meet various functional

needs. They often emphasize that improvements in economic welfare fostered by increasing the size of markets provide the impetus to liberalize and standardize economic exchange and harmonize regulatory frameworks. Non-state actors play a central role in this process. For example, Ernst Haas (1958) focused in part on interest groups and political parties to explain the EEC's origins. By promoting ECONOMIC GROWTH and managing economic problems among states, regional institutions can generate the loyalty of certain groups within states and create the conditions for these groups to demand further integration. The ongoing integration to which these demands give rise promotes the development of regional institutions. It also leads political actors to shift their loyalties and centres of activity from NATION-STATES to regional (or international) institutions, thereby diminishing the importance of states and increasing that of regional institutions. In addition, functionalists and neo-functionalists maintain that integration fosters political cooperation among members of regional institutions.

Standing in contrast to functional and neo-functional explanations of regionalism are those that emphasize POWER relations. Chief among them are realist and neo-realist theories (see NEO-REALISM; REALISM). By virtue of their stress on nation-states as the primary actors in the international system, these theories attach little importance to the domestic groups and transnational actors that functionalists and neo-functionalists highlight. Further, realists and neo-realists argue that the demands placed on states to attend to their security and the importance of political-military power in this regard render the distribution of power among states a central influence on international outcomes, including regionalism.

Realist analyses of regionalism have paid particular attention to the effects of HEGEMONY, which is one aspect of the international distribution of power. A number of studies have concluded that the erosion of hegemony tends to yield (among other things) the evolution of regional economic blocs (Gilpin, 1987; Krasner, 1976). Besides hegemony, other

aspects of power relations also have been analysed in studies of regionalism. For example, in a highly influential study, ALBERT HIRSCHMAN (1980 [1945]) argued that German decision-makers during the 1930s used discriminatory bilateral and regional trade arrangements with various countries in south-eastern Europe and elsewhere to enhance Germany's political power with respect to them.

Studies emphasizing power relations often suggest that regional arrangements tend to be protectionist. Discriminatory arrangements can both increase the aggregate MARKET POWER of members and limit their economic DEPENDENCE on non-members, thereby enhancing their economic and political security. Further, these studies often maintain that the protectionist tendencies of regional arrangements are likely to contribute to economic and political conflicts between them.

Related issues pertaining to regionalism

In addition to the issues discussed above, a variety of related topics pertaining to regionalism have attracted considerable attention among IPE scholars. First, does the number of parties to a regional arrangement influence its performance? Various studies have found that international and regional institutions help resolve COLLECTIVE ACTION problems among states. It is widely recognized that such problems tend to become more severe as the number of actors attempting to coordinate a given activity increases. That regional institutions can help overcome collective-action problems among a relatively large group of states with an interest in coordinating economic activity is one reason that has been advanced for their establishment. At the same time, however, the ability of regional institutions to do so may become strained if they include too many members. Much interest therefore has been expressed in the optimal size of regional arrangements.

Second, how does regionalism influence international bargaining and negotiations? Some scholars have argued that bargaining and negotiations are facilitated by reducing the

number of actors involved. In the same vein, regional economic arrangements may reduce problems of international bargaining by decreasing the number of actors participating in multilateral economic negotiations (see MULTILATERALISM). Other scholars maintain that discriminatory regional blocs can facilitate the negotiation of liberal trade agreements between members and non-members by mobilizing interest groups in non-members that prefer to expand commerce with members of the bloc and have the ability to pressure their governments to liberalize trade with members. If, however, members view regional arrangements as instruments with which to exploit their aggregate market power or as substitutes for, rather than complements to, multilateral efforts to liberalize economic exchange, regionalism may undermine attempts to negotiate liberal international economic agreements.

Third, whereas much of the existing literature on regionalism centres on its international causes and effects, the influence of domestic politics on the formation of regional economic arrangements also has been studied by IPE scholars. The relationship between government officials and interest groups is one aspect of domestic politics that has been stressed in this regard. As indicated above, political pressures exerted by interest groups that both have a preference for regional arrangements and influence over political leaders' capacity to retain office may prompt leaders to press for the establishment of new regional arrangements or entry into existing ones. Also emphasized has been how conflicts among interest groups over distribution of the economic benefits and costs that are generated by regional arrangements influence their establishment. Further, considerable interest has been expressed in whether regional arrangements promote economic reforms in member-states by insulating the public officials who undertake the reforms needed to comply with these arrangements from challenges to the reforms mounted by domestic interest groups that will suffer if they succeed.

Fourth, a striking feature of contemporary regional arrangements is the institutional

variation among them. The EU, for example, is highly institutionalized, whereas NAFTA is far less so; still less institutionalized is the ASIA-PACIFIC ECONOMIC COOPERATION FORUM (APEC). IPE scholars are devoting increased attention to the sources of these differences and the extent to which these differences influence the 'depth' of economic integration among members.

Fifth, scholars of regionalism have displayed a longstanding interest in the links between security and economic relations. Recent studies have analysed whether political-military alliances influence both the formation of PTAs and their effects on trade flows among members. In addition, the effects of power relations among states on both their propensity to establish regional economic arrangements and the particular institutional attributes of these arrangements have been examined. More generally, considerable interest has been expressed in the relationship between regionalism and political conflict. As noted above, some observers fear that the current wave of regionalism will undermine the system that has guided international economic relations for the past half-century and that this could lead to both economic and political conflict among regional blocs. Others, however, are more sanguine. They view regionalism as a potentially liberalizing force, which is likely to foster international economic openness and inhibit political and economic conflict.

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EDWARD D. MANSFIELD

regulation

Regulation is a political act: it involves government intervention in markets in response to some combination of normative objectives and private interests, reflected through POLITICAL ECONOMY.

The framework or design of regulation could be a principal-agent relationship – with, for example, the regulator representing the 'principal' and those regulated representing 'agents' – and/or a game (see GAME THEORY), in which conflicts emerge and have to be settled through a regulatory act. In these types of settings, the design of regulatory policies takes into account the opportunities for strategic behaviour provided by incomplete information and limited observability on the part of the regulator. Informational asymmetries between the regulator and the regulated lead to specific structural and behavioural features of the regulatory mechanism. These are an 'adverse selection problem', in which the relevant characteristics of one party (for example, the regulated firm) can not be observed by another party (for example, the regulator), or a 'moral hazard situation', in which one party can unilaterally undertake actions that cannot be monitored or controlled by other parties in the relationship.

From a mechanism-design point of view, regulatory policies appear as endogenous responses to information asymmetries and limited observability, rather than as exogenously specified mechanisms. Against the normative perspective, from a political view, perhaps the most significant feature of regula-

tion is that it redistributes income, creating winners and losers, thereby shaping interest groups and coalitions. The central economic argument for the regulation of an industry has been MARKET FAILURE and corrective action. Those market failure rationales embrace (1) natural MONOPOLIES (water, railways, utilities) in an attempt to counter monopolistic abuse and 'deadweight loss' (that is, the welfare loss induced by the difference between average and marginal cost pricing); (2) imperfect information (setting standards and quality), and (3) external effects and public goods (environmental regulation, allocation of use of electromagnetic spectrums for broadcasting television, zoning regulation). According to this view, DEREGULATION occurs when the costs of regulation exceed the transaction cost of repeal, plus the cost of the remaining market failure.

The most forceful argument is related to the natural MONOPOLY case. Here the view was presented that regulation was justified in the case of natural monopoly because ECONOMIES OF SCALE were so striking that a single firm (for the entire industry) can serve the market at lower average costs than more than one firm. Examples include electric power and gas distribution, local telephone service, rail transport and pipelining natural gas and petroleum. However, this argument fell into disrepute, in particular for natural monopolies with multi-product lines. Questions were raised: Why and when should a natural monopoly be regulated? Which alternatives are more likely to provide economic benefits to consumers and producers?

Since government intervention through regulation could only sustain regulatory outcomes (through subsidization or appropriate pricing schemes) as second-best welfare economic solutions (see SECOND BEST, THEORY OF; WELFARE ECONOMICS), alternatives to regulation were proposed that could yield similar or better results with lower costs. Suggestions included schemes like 'Demsetz competition', which allows competition for, rather than within, the market, involving competitive bidding between prospective entrants for the franchise rights to serve the market. Other

forms are 'contestable markets' and some forms of MONOPOLISTIC COMPETITION.

Two major forms of regulation can be distinguished: economic and social regulation. Economic regulation emphasizes price, rate-of-return and entry regulations, and is justified on the grounds of taming MARKET POWER and defending the public interest. Social regulation (or health, safety and environmental regulation) emerges from the state's obligation and paternalistic concern to protect its citizens' health, safety and environmental well-being. In modern industrialized economies, economic regulation has been uniformly in retreat through deregulation and regulatory reform, whereas social regulation has been gradually on the rise, partially fuelled by strong public pressure. Taking both forms of regulation together, about 30 per cent of US GROSS DOMESTIC PRODUCT (GDP) was generated by regulated industries in the early 1970s, dropping off to 20 per cent by the mid-1980s, with a further downward trend since then (though its composition has changed). All in all, a similar pattern has not yet emerged for trade in the EUROPEAN UNION (EU) states, with the possible exception of the United Kingdom.

The performance of regulated industries have been, at best, mixed. In general, regulated industries were below average in terms of productivity growth, lagged behind with investment and innovation, and consistently showed lower returns on investment and profitability than their non-regulated counterparts. Based on a number of regulatory cases, scepticism has grown on the presumed effects of economic regulation (for example, attempts to benefit consumers by reducing prices to a level closer to marginal costs). For example, the conclusions of the seminal Stigler-Friedlaend study (1978) were:

- 1 The regulatory commission had no demonstrable effect on electric utility pricing of natural monopoly because of long-term competition (between oil, gas, coal).
- 2 Utilities were unable to secure rents of sufficient magnitude for regulators to constrain.

regulation theory

Therefore, if regulatory rate-setting could not be shown to have reduced electricity rates, what then could have been its purpose? Other case-studies of regulation in the United States sometimes show inconsistent, unintended and non-beneficial results. For example, prior to deregulation in 1978, the Civil Aviation Board (CAB) awarded air routes restrictively, with lucrative routes going to weaker carriers. Fares were based on distance so that short-haul routes were subsidized by the high margins on long-haul routes. The consequences were high prices for consumers, high costs and little profits for carriers. Furthermore, CAB-regulated fares were higher and average load factors were lower. In addition, regulated fare structures deviated from efficient pricing rules.

As for the effects of regulation on innovation and productivity growth, other case findings confirm: (1) rate and 'certificate-of-need' regulation of hospitals slowed the diffusion of CT scanners; (2) productivity growth in the regulated US railway industry lagged substantially behind the (non-regulated) Canadian railway industry; (3) Food and Drug Administration (FDA) regulation on safety/efficacy of prescription drugs showed the costs of reduced innovation (the introduction of fewer new drugs) greatly exceeded savings from avoiding ineffective drugs. Regarding the effects of price regulation on product quality, airline price regulation induced non-price service competition, so that - for given consumer valuations of service quality - flights were too frequent, load factors on average too low and costs too high.

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regulation theory

Regulation theory is concerned with the reproduction of capitalist economic and social relations over time. As a distinctive theoretical approach to the problem of capitalist reproduction, it developed in France in the 1970s in and through a critique of pre-existing approaches within Marxist political economy (see MARXIAN ECONOMICS). It is associated in particular with the work of Michel Aglietta, Robert Boyer and Alain Lipietz and, however problematically, with the concepts of Fordism and POST-FORDISM. Despite or perhaps because of its growing and pervasive influence within contemporary political economy, the concept of *régulation* itself has been and continues to be fraught with ambiguity and attendant confusion. As a consequence, regulation theory tends to exhibit a somewhat schizophrenic character. For the distorted and diluted regulation theory popularized within Anglophone political economy and political sociology often bears little or no resemblance to that developed by the theory's original proponents and principal protagonists.

That this is the case is at least in part due to the terminological ambiguity of the concept of 'regulation' in the English language. For while the English term 'regulation' is generally counterposed to 'deregulation' and hence connotes a sense of rule-making and the conscious and legally codified intervention of the state within the economy and society (the sense captured in the French term *règlementation*), the French term *régulation* refers in contrast to

the often implicit routines, norms and conventions by which actions become regularized or normalized. It is this latter sense of the term that provides the principal theoretical focus of the Regulation School. Thus, as Bob Jessop notes, '*régulation* might have been better – and less mechanically – translated as regularization or normalization' (Jessop, 1995: 309). Similarly, as Robert Boyer notes with some frustration,

because they are homonyms the idea of regulation is [often] assimilated to that of administrative rule-making ... from this has arisen the impression that the whole approach is nothing more than a variant of Keynesianism or the institutions established under the New Deal!

(Boyer, 1990: 21)

The term *régulation* was in fact first used in the sense later deployed by the regulation theorists by the French philosopher Georges Canguilhem. He defined *régulation* as

the adjustment, in conformity with certain rules or norms, of several movements or acts, and their effects or products, which are initially distinct due to their diversity or succession.

(Cited in Boyer, 1990: 15–6)

This understanding of the term was appropriated by Destanne de Bernis, in many respects the founder of regulation theory, in developing a critique of theories of GENERAL EQUILIBRIUM taken from NEO-CLASSICAL ECONOMICS. De Bernis argued that CAPITALISM was not reproduced inevitably, but that certain social practices and procedures – or modes of regulation (see MODE OF REGULATION (MoR)) – were in fact required if capitalist accumulation was to proceed in the face of its inherent contradictions and crisis-tendencies. This observation led de Bernis and his collaborators to a periodization of capitalist development into three stages: (1) competitive or liberal capitalism, (2) simple MONOPOLY CAPITALISM and (3) state monopoly capitalism. Each was characterized by a distinct mode of regulation.

Though de Bernis can rightly be regarded as the founder of the regulation approach, giving

rise to the first School of Regulation in Grenoble, the later diffusion and profusion of regulation theory owes much more to the Parisian School and, in particular, to the pioneering work of Michel Aglietta. His distinctive approach to capitalist regulation arose as a critique of what he saw as the structuralist strictures of the (then dominant) Althusserian brand of Marxism. For Althusser and his followers, capitalist reproduction was unproblematic, apparently immune from crisis and seemingly inevitable. This view the regulationists rejected. Returning to MARX himself, the early regulationists asked how it was that despite capitalism's inherently antagonistic, conflict-ridden and crisis-prone nature, capitalist accumulation proceeded for the most part in the absence of significant structural crises. In short, they problematized the notion of capitalist reproduction that the Althusserians had taken for granted, by seeking to identify the conditions under which capital accumulation was possible at specific times and in specific places. Replacing the certainty of *reproduction* (within the Althusserian schema) with the more contingent notion of *regulation* (in their own) they examined the institutional forms and societal norms that served to 'attenuate', 'displace' or 'stall' the inherent contradictions of capitalism for particular periods of time in particular contexts. Echoing de Bernis, they argued that the reproduction of capitalism was not inevitable but contingent, depending on the existence of a stable REGIME OF ACCUMULATION (ROA) and a complementary mode of regulation.

The central and defining contribution of regulation theory can then be simply stated. It relies on two key observations: (1) capitalism as a MODE OF PRODUCTION is inherently unstable, characterized as it is by class conflict and social antagonism; (2) the history of capitalism is one of a succession of patterns of economic development and expansion, punctuated only infrequently by structural crises. This presents a central paradox: How is it that, despite its fundamental contradictions, capitalism exhibits apparently stable periods of sustained economic growth? The answer to this question

is found in the concept of regulation itself. Indeed, Alain Lipietz goes so far as to define 'regulation' as the way in which a social system reproduces itself despite – and indeed *through* – its own contradictions.

The approach that thus emerges is characterized by a concern with, and focus on, the evolution and transformation of capitalist social relations and institutions over time. Regulation theory produces a nuanced and sophisticated periodization of capitalist development into a succession of stages, each distinguished by a particular regime of accumulation and attendant mode of regulation. The view of capitalist development that it presents is one of 'punctuated equilibrium' or, more accurately, 'punctuated evolution':

- 1 capitalism requires regulation for its expanded reproduction;
- 2 specific modes of regulation emerge in the context of crisis and become institutionalized;
- 3 such regulatory forms (institutions, norms, conventions and so forth) serve to displace, manage or attenuate the contradictions of the accumulation process for a particular period of time in a particular context;
- 4 while this continues to be the case, capitalist development takes the form of a gradual evolution within the context of a stable mode of economic growth;
- 5 external shocks, technological developments or the process of evolution itself, however, may have the effect of destabilizing the mode of regulation such that latent contradictions and tensions now return to the surface;
- 6 under such conditions a structural crisis of the mode of regulation and regime of accumulation can be said to exist, initiating a period of (class) conflict;
- 7 the outcome of the moment of crisis cannot be predicted in advance, contingent as it is on the nature of the ensuing struggle and the alternatives offered;
- 8 eventually a new mode of regulation may emerge and become institutionalized, restoring the conditions of capitalism's expanded reproduction.

The proliferation of regulation theories and schools has, perhaps inevitably, resulted in a profusion of regulationist terminology and in some cases redundant jargon. Nonetheless, three key concepts can be identified that are crucial to any understanding of regulation theory: regime of accumulation, mode of regulation and mode (or model) of growth.

A *regime of accumulation* refers to a particular pattern of economic evolution, linking production and consumption, which can be stabilized over time despite its internal contradictions and crisis-tendencies. It relates, above all, to specific institutional structures governing the relationships between and within firms and between capital and labour during a phase of sustained economic growth. As Boyer notes, a regime of accumulation is

a set of regularities that ensure the general and relatively coherent progress of capital accumulation, that is, that allow for the resolution of or postponement of the distortions and disequilibria to which the process continually gives rise.

(Boyer, 1990: 35–6)

A *mode of regulation* refers to that ensemble of norms, institutions, routines, practices and procedures that, in their complex relationship, serve to ensure the expanded reproduction of capital by channelling or mediating contradictions in such a way that they do not threaten to undermine the regime of accumulation. The mode of regulation thus relates to the mechanisms and processes by which the expectations and contradictory behaviours of individuals and organizations are shaped, moulded and adjusted to the functional requirements of the regime of accumulation. A mode of regulation is in one sense, then, the very condition of existence of a regime of accumulation. As Boyer notes, a mode of regulation is

any set of procedures and individual or collective behaviours that serve to: reproduce fundamental social relations ... ; support and steer the prevailing regime of accumulation; [and] ensure the compatibility over time of a set of decentralized decisions,

without the economic actors themselves having to internalize the adjustment principles governing the overall system.

(ibid.: 43)

When a mode of regulation exists which complements and stabilizes a regime of accumulation, a *mode* or *model of development* can be said to exist. To identify such a mode of (capitalist) development is to point to a particular phase of capital accumulation in which the inherent and pervasive contradictions of capitalism have been attenuated and rendered latent, however temporarily. Here, there is an interesting parallel with the structure and form of HISTORICAL MATERIALISM. For in the same way that a complementary relationship between the forces of production and RELATIONS OF PRODUCTION (within the materialist philosophy of history) is the very condition of a stable MODE OF PRODUCTION, a complementary relationship between a mode of regulation and a regime of accumulation (within regulation theory) is the very condition of a stable mode of growth. The Marxist lineage of regulation theory is here clearly revealed.

The sheer diversity of regulationist approaches has ensured that there is no single periodization of capitalist development to have emerged from regulation theory. Yet, once again, by far the most influential account has been that offered by Aglietta and the Parisian School. In his seminal study, *Régulation et Crises du Capitalisme* (subsequently translated as *A Theory of Capitalist Regulation*, 1979), Aglietta distinguishes between two basic forms of capitalist development, characterized by distinct modes of expansion. In the earlier *extensive* phase of capital accumulation, capitalism expands by spreading into new areas of activity. During this phase, a competitive mode of regulation predominates. By contrast, in the later *intensive* phase, expansion is dependent on the reorganization of existing areas of capitalist activity to increase EFFICIENCY and hence the rate of relative SURPLUS VALUE. Though the mode of regulation within the intensive phase was first competitive, this proved incapable of generating sufficient demand to complement

the expansion of production enabled by TAYLORISM and the principles of 'scientific management'. The result was a severe structural crisis of overinvestment and crisis of underconsumption, precipitating the GREAT DEPRESSION of the 1930s. In the context of this crisis, a new monopolistic mode of regulation was to emerge in the post-war period. This was to encompass collective wage-bargaining backed by the unemployment and insurance provisions of a significantly expanded WELFARE STATE. The so-called 'Golden Age' of Fordism in the 1950s and 1960s was then characterized (at least within this somewhat stylized account) by the diffusion of Fordist production techniques (as Taylorism became automated) and by the stimulation of mass demand through the interventions of the state (associated in particular with the principles of Keynesian demand management and CORPORATISM).

Yet the Fordist mode of development would in turn give rise to its own distinctive structural crisis in the changed circumstances of the mid-1970s, as the perfection of Fordist production techniques left no space for further growth in productivity. On this much, the Parisian regulationists agree. Yet here there is a significant divergence of opinion. Some argue that a new and distinctive post-Fordist mode of development has already emerged, and that it is characterized by flexible specialization, the search for economies of scope rather than scale, and a workfare rather than a welfare state; others suggest that we are in the midst of an extended period of transition towards a post-Fordism that has yet to become firmly rooted and institutionalized, and whose precise form thus remains unclear; still others regard the politics of NEO-LIBERALISM and welfare retrenchment that seems to pervade the advanced capitalist economies as a symptom of the continuing crisis of Fordism, suggesting that no resolution is in sight (see ADVANCED CAPITALISM).

What this demonstrates is that regulation theory is unified much more by its methodology and the questions it poses, than by the answers it has as yet yielded. It also suggests that it is far more than the account of the

relations of production

transition from Fordism to post-Fordism to which it is so often reduced. Regulation theory is perhaps best viewed as an ongoing research project animated by a concern to elucidate the conditions for the expanded reproduction of capitalism.

See also:

capitalist crisis; flexible accumulation; Keynesian economics

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COLIN HAY

relations of production

Central to the explanation of different human societies proposed by KARL MARX is the overarching and inclusive concept of 'relations of production'. It is overarching because it refers to all social relations within entire societies; it is inclusive in that the production relations it considers are not simply those found in the workplace, but all those social activities that together contribute to the production and reproduction of human societies. 'Production' describes the human being's purposeful inter-relationship with nature. Such intrinsically human activity is always for Marx a social activity. Relations of production is a key concept for Marx, because he argues that all human societies are transformed and defined by the introduction of changing instruments of production. Instruments of production are those tools created by human beings – everything from ancient flint axes to modern satellite technology – whose function is to assist human beings in the creation and recreation of the environment in which they live.

Different historical epochs are understood by Marx as different modes of production and these are constituted by the interplay of instruments and relations of production (see **MODE OF PRODUCTION**). Capitalist relations of production are, for Marx, characterized by an antagonistic relationship between two social groups or classes. The first group is constituted by those who create value through labour – all those who work for wages in capitalist society; the second group is composed of those who own or control the means of production (land, tools and the labour of those who work for them) and who, therefore, receive the benefits from the working class (see **CLASS, WORKING**).

See also:

capitalism; Marxian economics; Marxism-Leninism

Further reading

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HAZEL SMITH

relief to development continuum

The concept of a relief to DEVELOPMENT continuum entered the public domain during the early 1990s, at a time when the total spending on humanitarian assistance (particularly in relation to conflict) was growing. It reflected an increasing concern over the possible harmful effects of prolonged relief assistance during humanitarian crises – in particular, that free food and other relief assistance may encourage dependency among recipients, discourage local agricultural production and, by acting as an incentive to warring parties, could even fuel conflict itself. The sentiments that inform continuum thinking, however, can be traced to the African famines of the 1970s and 1980s. These famines were generally regarded as natural disasters. At the time, there were also concerns about dependency. It was argued that the international relief response should help build local capacities to better manage future emergencies – for example, through training national staff as part of the relief effort and, where possible, purchasing local food surpluses rather than relying on imported food AID.

The continuum idea attempted to give these concerns an organizational dimension. Relief or, more accurately, relief agencies should be part of a comprehensive and coordinated

policy framework. Within this framework, relief should be planned to initially complement and, as soon as possible, give way to appropriate rehabilitation and development activities. At the very least, it should not undermine or hold back the resumption of development. In this respect, the continuum idea was part of the emergence of system-wide humanitarian operations led by the UNITED NATIONS (UN) following the end of the Cold War, which brought together UN organizations, aid agencies and donor governments in new ways. It also reflected the anxiety of development organizations, especially within the UN, to ensure their lead position within this framework.

There have been a number of critics of the relief to development continuum. While not rejecting its basic aims, some have questioned the timing or sequencing of the different activities involved. It has been argued that rather than a continuum (in the sense of a linear transition from one stage to another), it is possible for development activities to run alongside those of relief. In other words, it is not always necessary for a relief phase to have been passed before resuming developmental activity, even in conflict situations. Other critics have questioned the possibility of development within an ongoing conflict. They point out that continuum thinking emerged in relation to natural disasters. It assumes benign governments and representative administrative structures. Such a situation cannot be taken for granted in today's internal or ethnic wars and raises concerns about whose development is being promoted in such circumstances.

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MARK DUFFIELD

rent seeking

The study of 'rent seeking' is oriented around the competition for MONOPOLY rents, the monopolies themselves being created and maintained by governments. 'Monopoly rents' are resources generated above and beyond those that might be procured by suppliers of services that are made available in a competitive fashion. The seminal analysis of rent seeking was done by Tullock (1967), while Krueger (1974) coined the term and brought significant attention to the issue. Aside from the term 'rent seeking', the work on this subject is also referred to as 'neo-classical political economy'. The study of rent seeking essentially modifies the time-honoured neo-classical analysis of WELFARE loss from monopoly (see NEO-CLASSICAL ECONOMICS). Let us say a government is considering instituting QUOTAS on selected imports. In the traditional analysis of welfare loss, the quota would restrict domestic consumption of the protected goods, raise domestic production of the goods, as well as raise their prices. The consequences of the quotas would be to generate both a welfare loss to society through distortions in consumption and production, and a redistribution of wealth from consumers to producers (the higher monopolistic price would redistribute surplus from consumers to producers). The traditional neo-classical analysis has equated welfare loss exclusively with distortions in consumption and production. The principal contribution of rent-seeking analysis has been to suggest that welfare loss is much more extensive than a simple efficiency loss from such distortions, but that the social costs of monopoly *also* include a loss equal to that surplus which was redistributed from consumers to producers. This occurs because the market for monopolistic privilege is highly competitive, on both the buyer's and seller's side (as often noted in the rent-seeking literature, 'the creation of monopolies is a competitive industry'). In other words, actors who can benefit from receiving a monopolistic privilege will expend resources in trying to obtain it, while government officials

(who are candidates for these rewards as a result of having the power to grant monopoly privileges) will expend their own resources in trying to obtain them. In this respect, the contribution of rent seeking to the study of monopolistic inefficiency proceeds from the assumption that the creation of monopolies is not a costless process. In fact, it is just these costs that augment the traditional losses in efficiency that monopolies promote. It is a fundamental argument in this literature that the expenditure of such rent-seeking resources generates a social waste because they are used unproductively: they do not contribute to the creation of wealth in a society. The term DUP – 'directly unproductive profit seeking' – has been used extensively to describe such activity.

In the case of quotas, domestic producers (on the demand side) will compete in a multitude of ways to obtain protection for their goods: bribes, campaign contributions, lobbying fees and running ad campaigns in political districts, among other things. But politicians themselves (on the supply side) will compete to obtain these goods from domestic producers looking for protection: spend more time studying trade issues, invest more resources in convincing Congress or Parliament about the virtues of protection, familiarizing themselves with key import-competing industries. There are, as Buchanan (1980) pointed out, even wasteful consequences of creating third-party distortions. For example, export subsidies to one industry may lead other exporters to mobilize resources in competing for those transfers. In this case, all relevant wasteful activities from both the demand and supply sides apply. While Harberger's (1954) estimates of the social costs of monopoly, based on the neo-classical criteria, suggest a modest welfare loss, estimates which account for the social costs of rent seeking provided by Krueger (1974) and Posner (1975) suggest that the magnitude of monopolistic inefficiency can be quite substantial.

Of course, the act of rent seeking need not always result in welfare loss, especially where a second-best situation exists (that is, further market distortions actually lead to an improve-

ment of welfare). Obvious examples would be situations in which third-party distortions generate counter-coalitions which encourage policies that promote more competition. For example, tariffs may mobilize free-trade groups, and regulation may provoke anti-trust coalitions. In both cases, the costs of rent seeking could be more than made up by the welfare gains of trade liberalization and competition.

See also:

cartels; market failures; market power; second best; theory of

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GIULIO M. GALLAROTTI

research and development (R&D)

Technological developments, as well as other advances in the practices underlying economic activity, are often stimulated or even produced through the work of research and development (R&D) departments in companies. Additionally, the state may either support such activity directly through its TAX POLICY, or carry out R&D activities under its own auspices through the education sector or in defence-related research. In an information economy (see INFORMATION SOCIETY/ECONOMY) and especially in the KNOWLEDGE INDUSTRIES, innovation is one of the key elements to competitiveness. In the content industries and services, R&D may have less direct impact on the character of the product offered, but may significantly affect its delivery. But while R&D has become one of the most valued aspects of economic organization, not all innovation stems from actual R&D activities. Some innovations are developed through production practices or organically outside the realm of the company altogether. Additionally, individual inventors may produce the advances on which further competitive development can be based, while many innovations are the application of advances in one sphere to the organization or processes of another.

Commercial, competitiveness-oriented R&D should also be carefully distinguished from basic research in as much as R&D focuses on applied uses of new discoveries, as well as incremental improvements of currently used technologies and processes. Basic research, conversely, focuses on discovery and exploration of new areas without due emphasis on application. In the past, the assessment of R&D activities has relied on the sum of inputs into formalized company R&D activities to reveal its extent. However, given the need to also recognize non-company specific R&D and other sources of innovation and competitiveness in the global political economy, the

revealed comparative advantage (RCA)

systems of innovation (SI) approach has begun to find considerable favour.

SIs need not necessarily be organized on the basis of the state. Indeed, R&D is increasingly organized in networks that may be regionally focused or transnational within MULTINATIONAL CORPORATIONS (MNCs) and international joint ventures. The key role of the SI is to draw together disparate R&D activities within its given area and to allow cross-fertilization of innovation. Furthermore, using an SI approach encourages the contextualization of R&D in the social and non-economic process or relationships where it is rooted. The institutions that support R&D in any particular SI range from formal research organizations and company R&D units to INTELLECTUAL PROPERTY RIGHTS (IPRs), as well as the quality of the education sector's provision. Thus the differing balance and links between these aspects of institutional support may reveal why different SIs are more successful at R&D than others. The ways the institutions interact may encourage different activities and practices which produce different levels of innovation.

The need to innovate and compete on the basis of new products and processes is often regarded as a central element of national competitiveness, in addition to its value for the individual firm. As such, there has been considerable interest in possible policy support for innovation and the sorts of social infrastructures that are needed to support R&D activities. States' governments have always felt the need to support innovation, reflecting mercantilist ideas (see MERCANTILISM) in the last century and, more recently, the rubric of national competitiveness or the COMPETITION STATE. However, the difficulty of planning for innovation has meant that R&D support is a policy field riven with disagreement and dispute. There are concerns, for instance, that an overemphasis on applied R&D will lead to a dearth of progress in basic research, in the long run robbing R&D activities of the advances on which applied innovations are based. While R&D is recognized as important, its character and thus its support have proved less easy to agree on.

See also:

competitiveness of nations; industrial policy; List, Friedrich; technological capabilities

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CHRISTOPHER MAY

revealed comparative advantage (RCA)

Revealed comparative advantage (RCA) is a concept for quantifying the COMPARATIVE ADVANTAGE of individual countries by analysing their trade patterns.

According to the neo-classical trade model (see NEO-CLASSICAL ECONOMICS), comparative advantage is due to inter-country differences in FACTOR ENDOWMENTS. However, the usefulness of this approach to the measurement of comparative advantage is limited, as allowance has to be made for further inter-country differences (for example, productivity) and the relevance of non-price factors (for example, quality). Bela Balassa (1965), who introduced the concept of RCA, concluded that estimating the full range of factors that may determine comparative advantage is rather inefficient. It follows that comparative advantage is best 'revealed' by the factual trade performance of

individual countries, as the specialization pattern of trade reflects relative costs as well as differences in non-price factors. Thus the higher a country's ratio of the value of exports to the value of imports, the greater its comparative advantage within the category of commodity under examination is likely to be. For the purpose of cross-country analysis, the RCA index can be made comparable through appropriate 'normalization'.

Being a useful tool to quantify comparative advantage in general, the usefulness of RCA is diminished by the fact that the assumption of a global market free of distortions is not fulfilled in the real world. Moreover, at high levels of aggregation – where a commodity consists of multiple products – growing intra-industry trade also reduces the explanatory power of RCA (see TRADE, INTER-INDUSTRY AND INTRA-INDUSTRY).

See also:

competitiveness of nations; Heckscher-Ohlin-Samuelson (HOS) model of trade; trade theory

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PETER KÜHNEL

revealed preferences

Although some economists had already at the beginning of the last century put forward the view that market evaluations shown in prices were quite sufficient in determining demand

functions and that utility theory was unnecessary, most economists restricted themselves to questioning only certain aspects of the theory, such as cardinality or the possibility of making interpersonal comparisons of utility. In 1934, John Hicks and R.G.D. Allen formulated a new ordinal utility theory, but only four years later Paul Samuelson offered a replacement for it. According to Samuelson, the ordinalist revision of utility theory was not drastic enough. One ought to analyse the consumer's behaviour without having recourse to the concept of utility at all, since this did not correspond to directly observable phenomena. The new theory's main feature was a consistency postulate, which said that if an individual selects A over B, then they do not at the same time select B over A. From this postulate and auxiliary assumptions, all the main results of ordinal utility could be derived. After an amendment that assured integrability was introduced in 1950, the theory was brought to a close.

The theory of consumer behaviour had been developed in great part as an attempt to justify the idea of a downward-sloping demand curve. The utility theorists tried to deduce it from axioms and postulates on individuals' economic behaviour. Revealed preference theorists tried to build a new theory and to put it in operational terms. But the revealed preference theory was soon shown to be a complete logical equivalent of the regular ordinal theory; as such, it also shares regular ordinal theory's shortcoming of being empirically non-falsifiable, since in practice there exists no direct test of the preference hypothesis.

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LARS PÅLSSON SYLL

Ricardian theory of trade

In the textbook version, the Ricardian theory of trade shows that if there exist comparative technological differences between two countries in producing two goods, then each can specialize in producing one, trade to obtain the other, and both will benefit.

In the theory, production technologies are specified with labour as the only input. ABSOLUTE ADVANTAGE (or technological superiority) in producing a good is enjoyed when less labour input is required per unit of output. A country may be absolutely technologically inferior in producing both goods. However, if it is less inferior in one than the other, then it can still specialize in the less inferior line of production (where it enjoys COMPARATIVE ADVANTAGE), trade with the technologically superior country, and both still benefit.

However, for this trade to be feasible, the wage in the technologically inferior country must be lower than that paid in the superior country. Then workers in the former need not worry about competing with the relatively efficient workers in the latter country; at the same time, the high-wage workers in the latter country need not worry about competing with the cheap labour in the former country.

The benefit from trade, typically an increase in the consumption level, is static because it is a one-time gain experienced when the countries open up to trade. This is assured only after assuming that workers are fully mobile between the two occupations within each country: there is then no dislocation of workers and thus no repercussions. The theory cannot accommodate the possibility of UNEVEN DEVELOPMENT and growth between two trading countries. By focusing on international specialization in different goods, the theory also fails to account for the huge volume of intra-industry trade (see TRADE, INTER-INDUSTRY AND INTRA-INDUSTRY).

DAVID RICARDO is usually credited with discovering the theory, but some have awarded priority to Robert Torrens or James Mill. In

addition, Ricardo had actually devoted more effort to developing a class-based theory of trade and growth for land-scarce industrial countries – a theory through which he advocates repealing import barriers to primary products and necessities (see CORN LAWS).

See also:

general equilibrium

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P. SAI-WING HO

Ricardo, David (1772–1823)

David Ricardo is one of the greatest representatives of the Classical economics and is perhaps one of the most controversial economists of all ages. His most controversial and best-known work is *Principles of Political Economy and Taxation* (1817). To Ricardo, political economy is concerned with the laws that determine the division of the product between the production-centric classes. Ricardo's contribution lies in the introduction of a theoretical framework of analysis which is not only analytical but also *iconoclastic*. Ricardo built up, one might say, an engine of analysis that could effectively explain the classical economic problems of his time. His greatness also lies in recognizing several important issues and questions of international political economy (IPE) that subsequently became prominent in the literature on the subject.

Ricardo had the ability to build up analytical models, involving functional relationships between a number of variables, and to draw valid conclusions. Like other classical economists, Ricardo mostly used deductive methodology. He was also concerned with empirical problems but, in many cases, the empirical

conclusions could not be found to be wholly true. Very often, Ricardo used methodological reductionism to arrive at practical conclusions. He had the idiosyncrasy of drawing generalizations without going into the empirical truth of the involved problem. This particular predilection is often regarded as the 'Ricardian vice' (Schumpeter, 1968: 473). An example of one such Ricardian vice is the dictum that wage and price are inversely related.

Value analysis

Ricardo explained three types of value:

- 1 value relevant for scarce commodities,
- 2 value relevant for reproducible commodities, and
- 3 market value and normal value.

In the case of non-reproducible scarce commodities, Ricardo pointed out that value is determined by the intensity of demand. But, in the case of ordinary reproducible goods, value depends on the amount of labour necessary to produce them. If a commodity is produced by labour and capital, since capital can ultimately be reduced to labour, value would ultimately depend on the labour-content of the commodity. If the commodity is produced by the joint efforts of land, labour and capital, the value of the commodity will depend on the cost of labour embodied in the commodity plus the cost of labour that represents the cost of capital after conversion of capital into labour. In the long run, factors of production will have their normal values, and supply responds to demand in such a way that the value is equated with cost of production. The market value, on the other hand, is determined by the demand and supply. In the Ricardian schema, an increase in wages lowers profits, and a fall in profits lowers the value of capital-intensive goods *vis-à-vis* labour-intensive goods. Therefore, capital-intensive goods will receive a stimulus. Thus the average production period is lengthened. HAYEK termed this the 'Ricardo effect'. The Ricardo effect remains an important concept

for the understanding of trade cycles in the global economy.

In a multi-sector model, value is determined by the labour cost and profit (capital cost). The difficulty introduced by the element of profit did not pose any real difficulty for Ricardo. He came to evolve an empirical LABOUR THEORY OF VALUE which Joseph Stigler calls the '93 per cent labour theory of value' (Stigler, 1958). The empirical labour theory of value had been the basis of Marxian political economy and, later on, was used by Arghiri Emmanuel and others to explain UNEQUAL EXCHANGE between developed and LESS-DEVELOPED COUNTRIES (LDCs).

Ricardo was thus in search of an invariable measure of value. Initially, he used gold as a standard commodity, then switched over to a corn-measure in his *Essay on Profits*. Finally, however, he selected labour-content as the invariable measure of value.

Distribution

Ricardo was interested in finding out the principle by which the income of different factors of production can be determined. According to him, distribution is the principal problem in political economy. He was of the view that as the economy develops, the relative shares of wages, profits and rent will vary. As NICHOLAS KALDOR observed, Ricardian theory of distribution is based on two principles: the 'marginal principle' and the 'surplus principle'. The marginal principle discusses the share of rent and the surplus principle is applied to the division of surplus between wages and profits. In Ricardo's analysis, the output of the economy is distributed between three major shares: rent, wages and profits. Wages are the return to labour and are equal to subsistence. Profit is the residual and declines in the long run. In his analysis, wages and profits are inversely related. This is, in fact, his fundamental theory of distribution.

Ricardo made a lasting contribution to the analysis of rent. Rent is a payment arising out of the original and indestructible powers of the soil. The differential surplus, called rent, arises

whenever inferior land is brought into cultivation. Rent is not due to the bounty of nature but to her niggardliness. The market price of any commodity is equal to the cost of producing it on the marginal land (price is equal to marginal cost). Rent is really a surplus over cost. It does not determine the price, but it is determined by it. Rent is a form of unearned income. It does not represent any labour or efforts on the part of the landowner. Ricardo's theory of rent was developed as a protest against the landed aristocracy in England, at a time when the CORN LAWS were creating a great sensation. Through his rent theory, Ricardo wanted to point out the manner in which a tenant is exploited by landlords. He wanted to disprove the physiocratic misconception that the bounty of nature was the cause of rent. He believed that technical improvement in the short-run will lower the rent. Therefore, the landlords are not interested in applying technical improvements on land. Ricardo was in favour of repealing the Corn Laws because the import of corn would decrease its price, which would benefit the ordinary consumers and poor people. However, this might jeopardize the interest of the landlord in the form of reduced rent, but the loss of welfare by the landlord is more than compensated by the welfare gain of the consumers.

Ricardo recognized the conflict of interest between landlords and other classes of the population. He was of the opinion that, in the long run, as the share of rent goes up, the money rate of wage increases and the share of profit declines. He not only demonstrated the possibility of increased accumulation of unearned income in the hands of landlords, but also expressed concern over the unproductive nature of the landowning class. Ricardo's analysis of distribution of product raised the question of class relations and directed attention to social, political and historical factors in the realm of political economy. He provided the building blocks for socialist economics and brought to the surface the question of class conflicts in capitalism that constitutes an important dimension of IPE.

Barkai (1959) has pointed out that the

Ricardian theory of distribution is indeterminate. Be that as it may, Ricardo's theory of distribution does convey the important message for the theory of political economy that it is possible for the unproductive 'rentier class' to get the lion's share, while the most productive class (labour) gets only the subsistence wage. Therefore, there is an unequal income distribution in the society. This idea was later elaborated by KARL MARX, among others.

Magnificent dynamics and stationary state

Ricardo's ideas on stationary state are an extension of his theory of distribution. He believed that growth resulted from capital accumulation; but capital accumulation was a function of profit, which depends on wages. Wage levels, in turn, depend on the price of foodgrain (wage goods) and foodgrain prices depend on the availability of either new land or food imports. In a growing economy, as output (income) increases, rents rise, money wages go on increasing and profits go on declining. At the point where there is a 'stationary state', the profit rate becomes zero, rent becomes very high and money wages rise considerably. Growth is possible only up to a point and cannot continue indefinitely because of diminishing returns to labour and capital. All expansion ultimately stops and there comes the stage of stagnation. Ricardo understood the fact of LIMITS TO GROWTH. These limits are brought about by unequal and unwise income distribution, where the unproductive rentier class gets more but the productive working class receives much less. The limits to growth are the by-products of distribution, which is a reflection of the state of the political economy.

The glut controversy

THOMAS MALTHUS propounded the view that a capitalist economy gives rise to OVERPRODUCTION and glut mainly because of UNDERCONSUMPTION. Ricardo contested this argument. He pointed out that SAY'S LAW of the market (which states that supply creates its own demand) is valid in a capitalist economy.

Moreover, capital accumulation cannot continue indefinitely: the demand for capital is always balanced by the supply of capital. When capital accumulation goes on increasing, the wage level goes up and level of profit therefore goes down. This sets the limit to capital accumulation. Sufficient investment will not be there, if there is no demand for it. According to Ricardo, an increase in wages leads to a rise in the rate of growth of population, and therefore of effective demand, which can ensure the clearance of the market. Ricardo thereby emphasized the corrective effect of the classical economic adjustment mechanism (market forces). His use of Say's Law is rather dogmatic but, given the premises and assumptions, it is logical. In the glut controversy between Malthus and Ricardo, Ricardo won: good logic, as Blaug observes, triumphed over bad (Blaug, 1986: 175).

Machinery and employment

Related to the system of capitalist development is the question of machinery and employment. Evidently, the discussion of machinery reveals a kind of dualism in Ricardo. In the first and second editions of his *Principles of Political Economy and Taxation*, Ricardo pointed out many beneficial effects of machinery – such as increase in per capita output, increase in profit, increase in the size of wage funds, higher wage levels for the workers and so on (Lekachman, 1959: 170–2). However, in the third edition of *Principles*, Ricardo admitted that machinery may be injurious to the working class. Subsequently, the whole idea and attitude of Ricardo on machinery underwent a drastic reorientation. He believed that machinery may lower output and increase unemployment. It may also reduce the wage fund, which might go against the working class. Machinery will increase capital intensity and the TECHNOLOGICAL CHANGE will make labour worse off: the living labour has to compete with dead labour. Ricardo never integrated his revised views on machinery into the rest of his analytical framework. His discussion of machinery opens up a whole series of unanswered questions

about the political economy of capitalist development. Some of Ricardo's views (particularly the effect of machinery on wages and employment) are not, however, theoretically tenable.

Taxation

One-third of Ricardo's *Principles* is devoted to the discussion of taxation, but he did not develop a general principle of taxation, nor provide any theoretical foundation for discussing the incidence and effects of taxation. He only discussed the impact of some individual taxes, such as commodity taxation, tax on profit, tax on rent, tax on houses, tax on gold, tax on land and so on. He was concerned to study the immediate impact of different types of taxation and their importance in the political economy of a capitalist system. He analysed taxes with reference to political economy and was concerned about the problem of equity in taxation. According to Ricardo, taxes can be devised to bring about an egalitarian state of affairs. He advised that when wages are at subsistence level, direct taxation either on wages or on the products of labour has to be shifted. If, however, taxes are shifted onto profit, there may be a danger of declining capital accumulation. This may have further deleterious effects on the wage fund and the working class. Thus Ricardo was against taxation on profits and wages. He was more in favour of taxation on surplus products and revenue. He recommended that taxes be so levied as to fall on every person equally, so that they will interfere as little as possible with the natural equilibrium of the system.

Foreign trade

Ricardo's contribution to foreign trade is well known and important for IPE. Ricardo wanted to ensure maximum benefits to the world population from the territorial division of labour through the help of FREE TRADE. He observed that the conditions that make possible international trade are quite different from those which make domestic trade possible

(Blaug, 1986: 123). Thus Ricardo explicitly recognized the need for a separate theory of international trade. This separate Ricardian theory was the theory of comparative cost. To Ricardo, the theory of absolute cost advantage is more suitable for inter-regional trade; for international trade, comparative cost is more relevant. The theory of COMPARATIVE ADVANTAGE says that a country may need to enter into international trade even if it can produce commodities at the lowest cost. What is crucial is not really the cost, but cost ratios of commodities (domestic rate of exchange). Ricardo had a two-commodity, two-country and one-factor (labour) model of international trade. On the basis of several assumptions, he explained his theory of comparative advantage, which is illustrated in Table 4.

As Table 4 reveals, trade will not take place in the case of equal cost differences. Absolute cost difference may make it favourable for both countries to participate in international trade. In the case of comparative cost principles, trade will take place because of domestic exchange rate differences between the trading countries. Comparative cost differences can satisfactorily explain the presence of trade, even in the case of absolute advantage of a single country in the production of both the commodities. Ricardo presumed that, in the case of trade, commodities produced by unequal quantities of labour are exchanged between the countries, and that free trade can ensure the mobility of factors of production so that the world community is able to take maximum advantage of such trade. But Ricardo could not extend his theory to take into account several countries and commodities simultaneously. He also could not theorize the distribution of gains from trade. However, he pointed out that balance of trade could be automatically adjusted through the mechanism of rates of exchange. In this connection, Ricardo's 'mint par' theory is an important contribution.

Monetary theory

Ricardo's contribution to the understanding of

monetary economics appears in his writings on *The High Price of Bullion*, where he clearly explained the theory of exchange rates under two conditions: gold bullion standard and inconvertible paper currency standard. Ricardo said that, in the case of the gold standard, the exchange rate can be determined by the 'mint par'. In the case of inconvertible paper currency, exchange rates can be determined by the purchasing power of the two currencies concerned.

Ricardo basically followed the quantity theory approach for analysing the value of money. In *The High Price of Bullion*, he tried to explain the inflationary problem in England at the time, observing that England's hyperinflation was caused by the over-issue of currency notes. He therefore suggested that money supply should be gradually decreased until the price of silver and gold bullion were brought to their 'mint par' points. He was of the opinion that it was the drastic depreciation in the value of currency which was necessarily responsible for the outflow of gold from England.

In his *Proposal for an Economical and Secure Currency*, Ricardo analysed the factors that were responsible for the determination of the value of money. For him, under competitive conditions of money supply, the value of money depends on its cost of production. A proper control over money supply could maintain the value of money at a level which would neither cause inflation nor depression. He was in favour of a paper currency standard, but he advocated the proper regulation and control of the paper money. Therefore, Ricardo proposed the nationalization of banks. He also suggested that the circulation of bank notes must be based on 100 per cent gold reserves. He strongly recommended paper currency because such a system could lead to convenience, stability and automaticity. Ricardo's plan to nationalize banks was a clear recognition of the necessity for a well-defined monetary policy controlled by a central bank. The importance of such a plan is specially relevant in the IPE of our times, as financial crises in many countries often occur due to monetary mismanagement.

Table 4 Labour hours needed to produce one unit of cloth and jute

Countries	Equal cost differences (Case 1)		Absolute cost differences (Case 2)		Comparative cost differences (Case 3)	
	Cloth	Jute	DRE	Cloth	Jute	DRE
India	10	20	$1c = 0.5j$	20	10	$1c = 2j$
Bangladesh	15	30	$1c = 0.5j$	10	20	$1c = 0.5j$
Trade position	No trade			India exports jute to Bangladesh	India exports cloth to Bangladesh	

Notes:

DRE = domestic rate of exchange

c = 1 unit of cloth

j = 1 unit of jute

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B.N. GHOSH

Richardson processes

'Richardson processes' is the general term applied to certain sorts of interactive processes where two hostile actors progressively increase (or sometimes decrease) their hostile responses to each other. The processes are represented by a set of equations that are collectively known as the 'Richardson model', after Lewis Fry Richardson (1881–1953), one of the earliest and still most significant peace researchers. He first proposed the model and did a lot of subsequent work on it. Richardson interpreted the model as relating to changes in hostility between populations. Many scholars subsequently have inter-

preted it as an arms race model and it is frequently referred to as such. In fact, the equations can be interpreted in terms of any interactive process. They have some similarity with some OLIGOPOLY and DUOPOLY models, and rather more distant similarities with predator–prey models. They are formulated in the strict hypothetico-deductive manner, by which interesting and non-self-evident conclusions are strictly deduced from a parsimonious set of assumptions. Some of these conclusions are counter-intuitive, as shown below.

In the basic model, Richardson assumed two mutually hostile countries. Each country has a desired level of arms determined by two factors pulling in opposite directions:

- 1 the level of its opponent's arms: the higher this is, the more arms a country wants.
- 2 the cost of armaments, which operates as a damping factor.

Both of these are standard assumptions. Richardson showed that they needed to be made more precise. The different relative importance of these variables can uncover totally different patterns to an arms race.

In Figures 10 and 11, the armaments of A are measured up the y-axis and the arms of B along the x-axis. The continuous line represents the level of arms desired by A for any given level of B's armaments. Below this line, A will feel insecure and increase arms; above it there will be excessive expenditure on arms. The broken line similarly represents the desired level of arms for B – movement here is from left to right. These can be referred to as the countries' 'security lines'. At the intersection point, they are in equilibrium.

In Figure 10, the response by both parties to the rival's armaments is modest. As B increases its armaments, A will respond but not too vigorously; B responds similarly. It follows that, in area F, A will increase its arms upwards and B to the right, together going in the direction shown by the arrow. We have an arms race, but one that is bounded by the equilibrium. From any point in the system, the arms levels will move towards the equilibrium point.

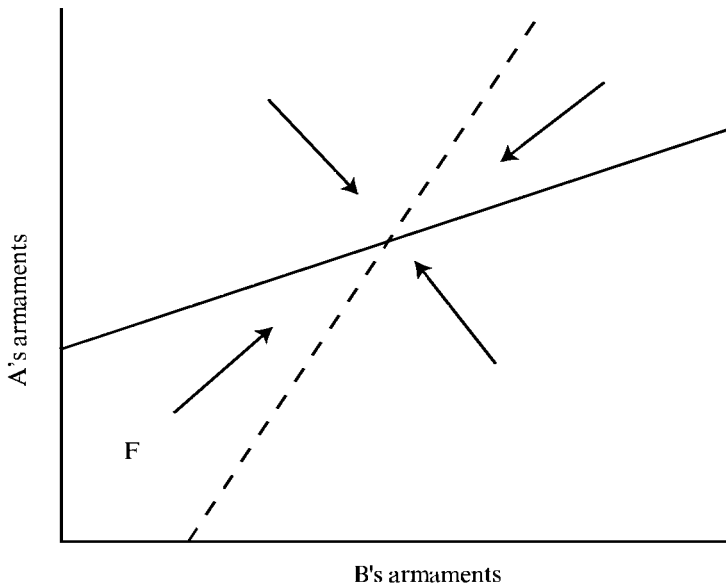


Figure 10 Stable equilibrium

This is called a 'stable equilibrium' and acts as an 'attractor'.

Figure 11 shows a system that represents more trusting behaviour in some ways and less trusting behaviour in others. If B has a level of arms of less than D, A will not feel any need to respond. However, if the level goes beyond point D it will respond vigorously – as is indicated by the steeply sloping line. There will still be an equilibrium in the positive quadrant but, as illustrated by the various arrows indicating time paths, this equilibrium is unstable. If the system is away from the equilibrium, the equilibrium will act as a 'repeller' rather than an attractor, and it is known as an 'unstable equilibrium'.

The Richardson model shows:

- 1 An arms race system can have an equilibrium. This means that an arms race need not go on indefinitely, but can settle down at some point.
- 2 However, this equilibrium is sometimes stable and sometimes unstable, depending on the values of the constants.

The apparently innocuous and commonsensical assumptions from which the analysis starts thus lead to counter-intuitive conclusions. These are not apparent from a purely verbal statement of the argument, which conceals the crucial implications of the different slopes of the reaction curves.

Richardson posed the model in terms of differential equations now widely referred to as 'Richardson equations'. In these equations, y and x are the levels of arms of country A and B respectively. dx/dt is the standard calculus notation for 'the rate of change of x with respect to time' and similarly for dy/dt . k and l , α and β are constants that indicate the strength of the variables they relate to, while h and k are positive constants that indicate the level of background hostility not directly related to the level of armaments. They can be negative and indicate friendliness. Using these terms, the differential equation that describes B's rate of rearmament is:

$$dy/dt = lx - \beta y + h$$

and the equation for A is:

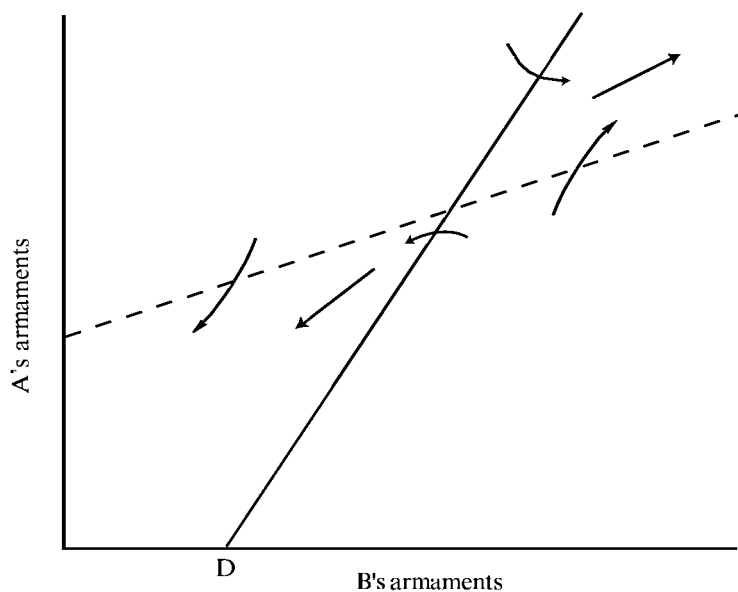


Figure 11 Unstable equilibrium

$dx/dt = ky - \alpha x + k$
 $dy/dt = 0$ gives A's security line, the broken line on the diagram. $dx/dt = 0$ gives B's security line. They meet at $dy/dt = dx/dt = 0$, which is the equilibrium point. The model is stable when A's security line is steeper than B's which, in terms of the equation, is when $\alpha\beta > 1.k$ and unstable if $\alpha\beta < 1.k$. See Nicholson (1989) for a more detailed discussion of this.

As it was posed by Richardson, the differential equation version was more complex, but lent itself more readily to elaboration and Richardson himself did so. Subsequent workers, such as Zinnes and Schrodtt (Schrodtt, 1981; Zinnes and Muncaster, 1984), have also used the differential equation version.

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MICHAEL NICHOLSON

risk analysis, political

Political risk is that element of business risk attributable to the political environment, and also to social and cultural (including religious) environments. which materially affects profitability and impacts on company goals, assets, operations and organization. Political risk also

incorporates the means of maximizing opportunities generated by these often overlapping environments.

Political risk is associated substantially with the operations of MULTINATIONAL CORPORATIONS (MNCs), based on FOREIGN DIRECT INVESTMENT (FDI). Such operations are now responsible for about a third of all world production by value and over half of world trade, and they underpin the emergence of global markets and GLOBALIZATION. Despite the consequent breach of state frontiers, the reality for MNC-management is that corporate operations remain governed by largely national legislation and political/social processes. It is not, therefore, surprising that the identification, assessment and management of political risk has become a significant management function. This is especially the case with businesses operating in sectors such as energy, defence, aviation and agriculture, where relations with governments are particularly close and problematic.

Although governments are the major political actors with which business has to deal, there are others whose importance depends on the circumstances. They include trade unions, environmental and social pressure groups, religious institutions, the military, international organizations and, at the extreme, terrorist movements and saboteurs.

Political risk literature has traditionally focused on the dramatic, such as the nationalization or sequestration of multinational corporate assets, assassinations of senior corporate management, and the impact of wars or civil strife in areas of political instability. However, this is misleading. Such events are extremely rare as far as international business is concerned. More importantly, since corporate investment is directed for the greatest part to developed economies, far more mundane risks are generated by the political process which, nonetheless, are expensive and time-consuming to manage. They include health and safety/environmental regulations, POLITICAL BUSINESS CYCLES, government procurement policies, local content rules, NON-TARIFF BAR-

RIERS (NTBs), consumer protection, competition policy and TECHNOLOGY TRANSFER.

Political risk management is essentially proactive rather than reactive – as much about opportunity-maximization as risk-minimization. Governments and MNCs have interests in common (such as investment in technology and training) and the scope for MNCs to influence public policy is considerable, particularly in developed economies. While corporatist-based political economies (see CORPORATISM) appear to offer greater opportunities for mutually fruitful relationships between governments and business than do more market-based environments, the reality is that generally there are pitfalls in both and little difference in policy outcome.

Political forecasting is an established feature of political risk analysis, characterized by independent consultancies utilizing a number of approaches of various degrees of sophistication. Two methodological issues predominate: (1) the need to present subjective judgements in as much of an objective form as possible and (2) the quantification of essentially qualitative assessments of the direction and impact of political change, in so far as they affect business. Indexing and the weighting of risk categories are particularly problematic. Quantification is regarded as essential, as such data is familiar to multinational management. Scenario-planning is another tool in the development of future strategy – an approach particularly favoured by the energy sector.

The incorporation of political risk assessment and management within management decision-making as a whole is a management skill. It involves a careful balancing of commercial imperatives, business interests and political sensitivity to what is relevant to a particular company. For companies operating across state borders, it is one of the most daunting of management tasks.

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TONY THORNDIKE

RISK, SYSTEMIC *see* systemic risk

risks

'Risks' arise from imperfect information about and lack of control over the contributing factors to any occurrence. Risk is the recognition that losses (economic, political, social) or disadvantageous outcomes are possible, but not certain. Levels of risk may be appraised through statistical analysis and partial control of contributing factors may be possible, but in complex political economic relations no outcome can be completely controlled or predicted.

Companies and individuals can pay a fee to insure the risk of negative outcomes. The insurer in specified circumstances will make good any loss incurred. The **INSURANCE INDUSTRIES** have developed by aggregating risks of negative outcomes across a large number of similar activities. In financial markets, contracts (**DERIVATIVES**) have been developed which insure market risks ranging from **EXCHANGE RATE** fluctuations to commodity price deflation. But some common risks, such as 'country' or 'sovereign risk' (in

economic relations between companies and governments), 'commercial risk' (when dealing with other companies) and 'political risk' (where negative outcomes from state policies may effect non-state economic relationships) are seldom insurable against.

Risks are one of the central concerns of actors in the international political economy, as all outcomes have costs which need to be distributed as well as benefits. What sorts of risks are and are not deemed acceptable reveal the values of particular political economic settlements (Strange, 1983). Risks are future expected benefits relative to present (and future) costs and, as risk assessment requires judgements to be made regarding the utility of outcomes against the exposure to possible costs, this cannot be neutral. The risk of some outcomes may be obscured or seen as unimportant: groups affected may lack the political and/or economic **POWER** to promote outcomes which would expose them less.

Risks also reveal opportunities for profit. The risk of failure and its costs are weighed by entrepreneurial actors against the opportunity to benefit from **INVESTMENT** and successful economic activity. Where possible, risks are transferred to other actors (through, for instance, insurance, profit-related pay, short employment contracts or secrecy about the risks of a product) and benefits retained.

Globally, there may now exist a 'risk society' (Beck, 1992). The risks of environmental catastrophe from local to global levels may produce an anxiety that has led to disengagement from political economic structures. With possibilities of environmental disaster, financial loss or social deprivation, the recognition and assessment of risks is neither easy nor uncontested. Risks and benefits are allocated socially and, within the international political economy, the power to transfer the risks of actions but retain the benefits of outcomes is unevenly distributed.

See also:

environmental impact of projects; Federal Deposit Insurance; sovereign debt

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CHRISTOPHER MAY

ROLLS OF OLERON *see* Oleron, laws of

ROME, TREATY OF *see* Treaty of Rome

Rostow, W(alt) W(hitman) (1916–)

One of the most important, influential and productive economists of the US post-war period, Walt Whitman Rostow's career in academia, government and public service is inextricably associated with three dominant issues: (1) post-war US foreign aid policy, in particular with the ALLIANCE FOR PROGRESS, (2) the Vietnam War and his close relationship to the Lyndon Johnson administration, and (3) his attempted refutation of the applicability of dialectical materialism as a model of theory and practice for the developing world by his 'aerodynamic' stage-theory model of development (detailed in his 'non-communist manifesto', 1960).

Rostow was born in New York City during World War I and was trained in economic history at Yale. He secured his Ph.D. in 1940, during the course of which he spent two years as a Rhodes scholar at Balliol College, Oxford.

Rostow worked for the Office of Strategic Services (OSS) during World War II and taught at Columbia and Oxford universities before serving with the Economic Commission for Europe. He finally settled at the Massachusetts Institute of Technology (MIT) in Cambridge, where he held an appointment between 1950 and 1961. He came to prominence in government and academic circles as the author of *The Stages of Economic Growth* (1960), a stage theory of economic growth which turned on the necessity for high saving to trigger the important 'take-off' period in his five-stage model. Arguing that the THIRD WORLD could replicate the experience of the West ('the drive to mass consumption') without resort to communism (though Rostow acknowledged that communist insurgencies were more likely in the turmoil of the take-off period), this book furnished much of the ideological basis for US foreign policy in the developing countries during the 1960s. He began to advise John F. Kennedy in 1957 and became chairman of the Policy Planning Council, a post which he held through the Johnson period. A supporter of the COLD WAR, Rostow believed in containing communist expansion which, in his view, took the form of wars of national liberation. The Taylor-Rostow Mission of 1961 recommended the sending of combat troops to Vietnam, and Rostow became a great believer in the tactical use of massive bombing in conjunction with ground forces to block the Ho Chi Minh trail. The influential 'Rostow Thesis' recommended destroying the means of external support for the insurgents (hence his support of physical and psychological assault in the bombing of Haiphong and the invasion of Laos). In 1966, after being named Special Assistant to the President for National Security Affairs, Rostow joined the inner circle of White House advisers consisting of (among others) Dean Rusk and Robert McNamara. He was *the* key individual who determined what reports President Johnson saw with regard to the war. He remained steadfastly loyal to Johnson and never wavered in his support, even as opposition to the war mounted. Rostow left office in 1969 and resumed an academic life, amid some controversy,

at the University of Texas, where he continued to write on world economic history and foreign policy, and worked on his own memoirs.

Rostow's economic work is typically seen as a pillar of MODERNIZATION THEORY, which fulfilled a similar function with regard to US hegemony (see HEGEMONY, US) as evolutionism did for late Victorian Britain. His optimistic expectation that late developers needed less time to achieve take-off echoed the ideas of ALEXANDER GERSCHENKRON, but with none of Gerschenkron's economic or political sophistication. Rostow's self-proclaimed magnum opus, *The World Economy* (1978), offers little in the way of a departure from his earlier work, though he came to see economics – and monetarist and Keynesian thinking in particular (see KEYNESIAN ECONOMICS; MONETARISM) – as incapable of addressing the central concerns of our time, especially with regard to food, energy, pollution and RESEARCH AND DEVELOPMENT (R&D).

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MICHAEL WATTS

rules of international systems

Rules of international systems are most cogently and parsimoniously described by realists ('condensed realism'). According to the realists, the international system will tend towards a balance of power, whereby one or more states balance the power of other states (see REALISM).

Rules of international systems vary depending on the POLARITY of the major actors. That is, the number of power centres in the world determines the rules of the international system and its members' important behaviour (namely, war). A unipolar system has one centre of power: a global hegemon. Because the hegemon manages the system to some degree, the likelihood of war is low. In a bipolar system there are two centres of power: as in the COLD WAR confrontation between the United States and the Soviet Union. While the Cold War was a relatively stable system (at least in retrospect), scholars disagree on the degree to which this type of system will always be stable and peaceful. They point, of course, to the bipolarity that prevailed on the European continent before World War I, arguing that the inherent instability of the existing alliances almost inevitably led to war. A tripolar system consists of three main centres of power. In reality such systems are unlikely to last long, because there is a natural tendency for two of the centres to join together to balance the other. Arguably, a tripolar system prevails today (at least if one focuses on economics and finance), with the three poles being North America, East Asia and Western Europe. With the present superiority of the United States, however, there are signs that leaders of the Asian and European centres will work together to counter US hegemony (see HEGEMONY, US). In a multipolar system, each state or small group of states has more or less equal authority *vis-à-vis* others. States may come together in international cooperative efforts to address problems of mutual concern. By definition this system does not have a hegemon that is able to thwart such efforts. However, the opposite could obtain, because COLLECTIVE ACTION becomes

more difficult as the number of power centres increases. What is more, some scholars believe that multipolar systems are the most dangerous, because there is no hegemon or alliance to impose restraint on warlike states. In the event, when such systems have existed (as in Europe in the nineteenth century) cooperation has been possible when states undertake concerted diplomatic deliberations to understand and resolve their differences, but at times there were significant wars to settle disputes and establish relationships in the system.

In addition to 'rules' of state interaction deriving from the nature of the prevailing international system, we can talk of accepted and agreed international rules and norms that frequently shape state behaviour. International rules in this context can be defined as 'specific prescriptions or proscriptions for action' (using the definition from Krasner, 1983) or:

well-defined guides to action or standards setting forth actions that members [of international regimes] are expected to perform (or to refrain from performing) under appropriate circumstances.

(Young, 1989)

The most fundamental rules of the international system – albeit broken on countless occasions and under challenge at the beginning of the twenty-first century – are respect for national SOVEREIGNTY and non-intervention. But increasingly there are rules and associated international regimes dealing with all manner of issues, ranging from economics and trade to environment, telecommunications and civil aviation. Countries adhere to these rules initially because it is in their interest to do so (thus, for example, pilots on international flights speak one language – English – to avoid mid-air collisions) or because they are compelled to do so by more powerful states. However, eventually the regimes in which rules are embedded can take on lives of their own, with states adhering to rules due to convention or because it is the right thing to do by prevailing international standards.

See also:

law, international: regime theory

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PAUL G. HARRIS

Rybczynski theorem

The Rybczynski theorem, named after its author Tadeusz M. Rybczynski, was presented in an influential paper on FACTOR ENDOWMENTS in 1955. Based on an economic model of a two-factor, two-good economy, the theorem essentially states that an increase in a factor of production will result in an increase in the output of the good that uses that factor relatively intensively and a reduction in the output of the other good. The intuition behind this model can be understood by realizing that

Rybczynski theorem

an economy's production possibilities (or TRANSFORMATION CURVE) will shift towards the good that uses the increased factor relatively intensively, utilizing more of both factors and taking away both factors from the other good's production, thus reducing its output of that good. While the Rybczynski theorem seems rather intuitive, there are important and unexpected generalizations and policy implications that flow from it.

A powerful implication of the theorem concerns the possibility of thwarted growth in LESS-DEVELOPED COUNTRIES (LDCs). Almost all LDCs aspire towards a capital-intensive industrial sector. However, assuming a competing sector that utilizes labour intensively and a high population growth-rate, capital intended for industrial development could be drawn into the labour-intensive sector. A growing population means an increase in a factor of production: labour. An increase in labour will, according to the Rybczynski theorem, increase the output of the sector that utilizes labour relatively intensively (often light manufacturing or export processing) thereby drawing both labour and capital away from the capital-intensive sector. While government policies could be introduced to counteract this effect, the Rybczynski theorem demonstrates that the goal of developing a capital-intensive industrial sector does not take place in isolation from other sectors.

A variety of endowments are considered factors of production, including natural resources. The Rybczynski theorem suggests that an increase in this factor will decrease output in sectors not intensively utilizing natural resources. For example, the discovery and exploitation of natural gas fields by the Netherlands is often seen as a cause of its sluggish performance in manufacturing. This phenomenon of DEINDUSTRIALIZATION or DUTCH DISEASE has been seen in many countries (for example, Australia, Mexico, the United Kingdom) where extractive industries have grown while manufacturing has suffered. This in no way suggests that aggregate wealth or welfare for the country is diminished. Rather, it forcefully brings home the conclusion

that one sector of an economy does not operate in isolation from the other sectors. What may seem to be an unqualified boon to an economy (the discovery of valuable natural resources) can, according to the Rybczynski theorem, be a mixed blessing in that potentially important sectors of the economy will contract.

Labour is a factor of production that varies with the skill of the worker. By categorizing labour as low-skilled and high-skilled it is possible to think of these categories as different factors of production. Thus an increase in one can result in a contraction of the sector where the other is utilized relatively intensively. A large migration of unskilled workers into a country would result in the contraction of the sector intensively utilizing high-skilled labour. The same logic holds for the impact of emigration. Understood in this way, the Rybczynski theorem suggests that the type of labour involved in migration can have an impact on the type of economic production that will occur in equilibrium, assuming that migration is of sufficient magnitude. Pushing the theorem a bit further, one can derive similar results for regions and even cities, given some level of trade friction (such as transportation costs) between regions.

It should be clear that the Rybczynski theorem suggests that significant changes in an economy are possible by varying the quantity of a factor of production. However, it should also be understood that important assumptions underlie the theorem that may mitigate its impact. This theorem, like its correlates the Stolper–Samuelson theorem (where free trade raises the income of abundant factor or factors in a country, while protection raises the income of the scarce factor or factors – see FREE TRADE) and the HECKSCHER–OHLIN–SAMUELSON (HOS) MODEL OF TRADE, drastically simplifies a complex reality to derive some hypotheses about specific elements of an economic system. A real economy has a variety of mediating variables that could mitigate or exacerbate the output predictions of the Rybczynski theorem. Finally, the theorem predicts certain market outcomes free of government intervention. A government is

Rybczynski theorem

always free to attempt to shift incentives to counteract the effects the theorem predicts.

See also:

capital mobility; factor mobility; labour mobility; Leontief paradox; neo-classical economics; trade theory

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M. SCOTT SOLOMON

S

Samuelson, Paul (1915–)

Paul Samuelson attended the universities of Chicago and Harvard, and took up the position of Assistant Professor in the Massachusetts Institute of Technology (MIT) in 1940. He has remained at MIT where he is now Institute Professor Emeritus. Samuelson's contribution to economics spans a wide range of areas, including consumer behaviour, capital theory, growth theory, WELFARE ECONOMICS, finance and international TRADE THEORY. Among many awards, he received the Nobel Prize in Economic Science in 1970.

Comparative statics underlies much of Samuelson's research and his development of international trade theory is no exception. Most of his work in international trade focuses on the neo-classical two-country, two-commodity, two-factor model. He developed a number of extensions to the model, building on the work of ELI HECKSCHER and Bertil Ohlin. His first paper on international trade was published jointly with William Stolper in 1941. Stolper and Samuelson showed that, in the neo-classical model, the imposition of a tariff will benefit the factor of production that is relatively scarce. Despite this result, however, they retained the FREE TRADE principle by arguing that the welfare loss to the scarce factor will always be less than the overall gain from trade.

Samuelson refined the earlier work of Heckscher and Ohlin on factor-price equalization in a series of papers published in the 1940s. Samuelson (1948, 1949) supplied the mathematical proof of the hypothesis previously put forward by Heckscher (1949 [1919]) and Ohlin (1933) that, in the neo-classical model, inter-

national trade in commodities can bring about complete equalization of factor prices across two countries, in the same way that complete international factor mobility would. Specialization in accordance with relative factor abundance causes demand for the abundant factor to increase relatively more than demand for the scarce factor. The price of the abundant factor will rise while the price of the scarce factor will fall. Samuelson showed that these factor price movements will continue until factor prices are equalized in both countries. The main issues to arise out of these papers were, first, whether the underlying condition of a univalent relationship between the price of factors and the price of goods held irrespective of factor prices and, second, whether factor-price equalization could be expected to hold in a multi-commodity, multi-factor model. These issues sparked off the publication of a series of highly formalized papers contributed to by mathematicians as well as trade theorists.

Significant changes have occurred since the 1970s in the way in which theorists approach the whole issue of international trade. The neo-classical model is now seen as a tool of limited usefulness in explaining the nature of international trade flows. However, there can be no dispute as to Samuelson's influence on the approach to international trade theory. He was the principal player in the development of a theory of international trade which dominated this branch of economics for almost fifty years.

See also:

Heckscher-Ohlin-Samuelson (HOS) model of trade

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SIOBHAIN MCGOVERN

sanctions, economic

'Economic sanctions' are a coercive measure that states use against one another in the pursuit of various foreign-policy goals. They can be defined as an interruption in usual economic relations between countries in an attempt to cause a change in the policies of the target country. The threat of sanctions, prior to their actual imposition, can also sometimes lead to desired policy change. Economic sanctions take a number of forms. Trade sanctions involve disruption of usual commer-

cial transactions, either by denying imports via a boycott or blocking exports via an embargo. Financial sanctions are also common and involve measures that restrict financial interactions by blocking flows of foreign aid, voting against loans from international financial institutions, limiting access to assets held overseas or related steps. Many authors distinguish 'positive' sanctions – the promise or provision of an economic reward – from 'negative' sanctions – the threat or act of economic denial.

Another important distinction is between sanctions imposed unilaterally or multilaterally. Multilateral sanctions are often (but not always) managed by INTERNATIONAL ORGANIZATIONS (IOs) including the UNITED NATIONS (UN) or the EUROPEAN UNION (EU). While economic sanctions are generally understood to be a state-to-state transaction, non-governmental, private and supranational actors can substantially influence their scope and effectiveness. For example, MULTINATIONAL CORPORATIONS (MNCs) can undermine sanctions by evading national controls and operating outside the constraints of domestic legal systems.

Economic sanctions are a common tool of modern statecraft, but they have a long history. Thucydides describes a case of sanctions during the Peloponnesian War, when Athens imposed a trade boycott on Megara, an ally of Sparta. The Napoleonic Wars gave rise to an extensive system of sanctions, as France organized much of the continent to limit sales of grain to Britain. Economic sanctions imposed early in the twentieth century earned this tool of statecraft a reputation for being ineffective. The most prominent case from this era was a boycott and limited embargo organized by the League of Nations against Italy in retaliation for its invasion of Ethiopia in 1935. However, the League failed to block exports of oil to Italy and the sanctions failed to have any noticeable impact on Italian actions. The use of economic sanctions characterized East-West interaction during the COLD WAR, has been frequent in North-South relations and is common in the attempt to isolate pariah states in the second half of the

twentieth century. Some prominent cases of sanctions have been undertaken by the UN, such as those against apartheid-era South Africa and Rhodesia, and against Iraq coincident with the GULF WAR of 1991-2. However, the most frequent source of sanctions since the 1940s has been the United States.

The range of actions by target countries that lead states to impose economic sanctions is large. The UN specifies that the Security Council use sanctions in the pursuit of international peace and security, which can be interpreted broadly. In practice, UN sanctions have responded to military invasion of another country (Iraq), domestic military conflict (Yugoslavia) and social issues (apartheid). Many US sanctions were driven by the international security dynamics of the Cold War. Beginning in the 1970s, the United States frequently used economic sanctions to respond to human-rights violations in other countries, including Latin American and Asian states. Since the end of the Cold War, economic sanctions are often directed against pariah states, those that flout fundamental norms of international society and pose clear threats to international security, such as the promotion of terrorism. Targets that fit into the pariah category include North Korea and Libya.

Most analyses of economic sanctions focus on the question of their effectiveness in causing the target state to change its policies in the manner demanded by the state, group of states or international organization imposing them. Establishing a causal relation between the imposition of sanctions and policy change is difficult, as multiple alternative explanations of any observed change must be ruled out. It is also difficult in many cases to discern the true intentions of those states imposing sanctions. Public statements about the purposes of sanctions may be deceptive, as the true target of sanctions may be other states or the public or interest groups at home. Even when a plausible causal relation can be established between sanctions and policy change, questions arise about whether the cost of sanctions to the state imposing them is worth the benefit achieved. Since sanctions involve the interruption of

customary, mutually beneficial economic relations, the country imposing them generally bears some costs. Blocking imports from the target state can raise prices for consumers and producers at home; blocking exports leads to the loss of profits and markets for exporters.

Taking these considerations into account, it is not surprising to find that many studies of economic sanctions, particularly those that concentrate on single cases like the League of Nations against Italy, argue that sanctions are ineffective and not an efficient policy tool. Targets often do not change their policy in the manner demanded by those imposing sanctions, as Iraq's refusal to reverse its invasion of Kuwait in response to sanctions illustrates. Similarly, most economic sanctions imposed by the United States against the Soviet Union during the Cold War (including a costly grain embargo in 1980) had minimal observable effects on Soviet policy. Even when economic sanctions are associated with desired policy change, as in the case of the end of apartheid in South Africa, questions remain about the extent to which sanctions should be credited with the success. In this example, some have argued that social sanctions (such as blocking South African participation in international sporting events) had a greater impact than economic sanctions *per se*.

More recent systematic studies of the effectiveness of economic sanctions have tended to come to a more affirmative conclusion than earlier single-case studies. A number of arguments bring the assumptions of the single-study approach into question. First, it is important to note that the fact that sanctions are costly for the state imposing them is not necessarily a criticism of their effectiveness. In fact, the costly nature of sanctions can make them valuable as a signal of intent, sending a clearer and more certain message to the target than less costly, more symbolic actions (such as diplomatic sanctions). David Baldwin (1985) has made this argument most clearly. A second important insight is that the utility of sanctions should not be evaluated in isolation, but in comparison to alternative policies. In many instances, the option of doing nothing in

response to threatening acts by other states is unattractive, involves its own costs and can be dangerous in the long run. On the other hand, the use of military force is costly and risky. Economic sanctions can provide a valuable alternative, moderating the costs and risks of policy but allowing states to send firmer signals than words alone can provide.

The most systematic study of a large number of cases of economic sanctions has been undertaken by Gary Hufbauer, Jeffrey Schott and Kimberly Elliott (1990). The authors study over 100 cases of sanctions in the twentieth century and draw generalizations about the degree of success and the factors that tend to make sanctions more successful. They find that sanctions met with some degree of success (defined as a desired change in the target's policies) in over a third of cases. Sanctions are less likely to succeed the more ambitious their goals are. That is, sanctions rarely lead to major policy change (such as reversing a military invasion or overthrowing a government) when used on their own. However, sanctions meet with a higher degree of success if their goals are more modest (such as demanding compensation for the expropriation of property or improving compliance with agreements about the use of nuclear fuels). Another important finding of the Hufbauer, Schott and Elliott study is that sanctions are not usually as costly to the state imposing them as earlier authors had claimed. Sanctions often take the form of cutting foreign assistance, which is actually a net benefit to the government's budget, or involve only minimal short-term disruptions in trade flows. This more systematic study of sanctions, by drawing attention away from the small set of intensely studied sanctions that had previously dominated discussion, has led to a re-evaluation of the costs and benefits of sanctions. On balance, more comprehensive analysis of the universe of sanctions cases has led analysts to the conclusion that they can be effective tools of statecraft, when applied selectively and with an appreciation of the conditions for their success.

Another dimension of the use of economic sanctions involves the problem of constructing

multilateral coalitions of states that will support their imposition. One common reason for the failure of sanctions lies in the ability of the target to find alternative markets for exports, alternative suppliers of imports or alternative providers of financial services. At the same time, states that are willing to defy sanctions, engaging in 'sanctions-busting' activities such as smuggling or providing vital imports in the face of an embargo, can reap high economic benefits. For these reasons, the construction and maintenance of coalitions of states that will limit the opportunities to evade sanctions is essential, but difficult. Instances where the failure to gain international cooperation was a major contributing factor to the failure of sanctions are easy to identify. US sanctions against Cuba were undermined first by the Soviet Union, then in the 1990s by the widespread refusal of European states and Canada to comply with US demands to cut economic ties with Cuba. When India publicly declared itself a nuclear power by conducting five test explosions in May 1998, the United States met with European allies to try to organize a vigorous sanctions effort. Such an effort not only could restrain Indian policy, it would send a message of resolve to Pakistan. However, the United States achieved only modest cooperation from its European allies.

Lisa Martin (1992) studied the conditions that allow for the successful construction of multilateral sanctions coalitions. She found that coalitions only form when the state taking the lead in imposing sanctions takes steps to demonstrate a credible commitment to the sanctions and puts forceful efforts into forming a coalition. Coalitions do not arise naturally, via consensus on goals and tactics. Arm-twisting is typically a central part of the coalition dynamic (as was seen, for example, during the sanctions coalition led by the United States prior to the Gulf War). Two factors in particular appear essential to the demonstration of a credible commitment. When the state taking the lead refuses to bear high costs itself, as for example the United States did in 1982 when sanctioning the Soviet Union while refusing to impose a grain embargo, it

cannot convince others to join a coalition. A second element of success involves the skilful use of international institutions, such as the UN. In the 1990s, the UN Security Council has been the focal point for construction of sanctions coalitions. International institutions provide a forum for negotiation among potential members of a coalition. They can assist in the creation of bargains among members of the coalition. They can also play a vital role in the maintenance of sanctions, by providing monitoring and enforcement capabilities. Sanctions remain a tool of foreign policy that states (particularly powerful states) will use in attempts to change the policies of others without resorting to military threats. However, we increasingly find that states only undertake these efforts after consultation and coordination with one another, and in the context of international institutions.

See also:

coercion; collective action; diplomacy, economic; multilateralism; re-exports; transshipment; vulnerability, economic

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LISA L. MARTIN

savings and loans (S&Ls) crisis

One of the costliest financial disasters of all time, the savings and loans (S&Ls) bailout of the 1980s and early 1990s involved hundreds of local savings banks (or thrifts) across the United States. The total cost of the US government-supported rescue package for these institutions is estimated at \$500 billion, with liabilities continuing to 2030.

The causes for the crisis include regulatory change; aggressive expansion into speculative real-estate financing; the misalignment between the high interest rates paid on deposits and low returns from long-term lending, and government policies that kept S&Ls open despite their shaky finances. Severe problems really surfaced when the junk bonds many of the S&Ls had purchased to improve their returns proved difficult to sell after the junk bond market collapsed following the stock market crash of 1987 and the arrest of junk bond king Michael Milken. New accounting rules required the thrifts to mark their (now almost worthless) bonds to the current market price ('mark to market'), effectively reducing these institutions to bankruptcy.

The positive side of this is that those institutions which survived are better organized and less vulnerable to collapse than before.

TIMOTHY J. SINCLAIR

Say's Law

Since the commercial expansion of the sixteenth century, writers have been expressing concern about the employment problem. This problem barely arose in the decentralized agrarian society that existed before. Rather, the employment problem is characteristic of a commercial market economy of the type that began to develop in the sixteenth century. In response to this development, several writers began to address the question of which forces determine the levels of output and employment in an economy as a whole, as opposed to

particular industries. The employment problem was recognized as such.

Mercantilists and physiocrats argued that economic growth and progress could be blocked by a shortfall of purchasing power. Moreover, they were afraid that the import of foreign goods could jeopardize domestic industries and employment. Classical economists, however, rejected this view. They argued that departures from full employment in the economy as a whole would be temporary and rare. They tried to look behind the monetary veil by separating the problem of money from the analysis of the real economy. The underlying real economy was believed to be subject to Say's Law, named after the French economist Say (1767–1832), an early supporter of the Classical School.

In 1803, Jean-Baptiste Say (born in Lyon) published his most famous book, *Traité d'économie politique* (A Treatise on Political Economy). He put forward the view that the free enterprise economy will automatically reach an equilibrium at which there is no unemployment and no INFLATION. Thus he was against government intervention in the economy. As a result, he suffered the wrath of Napoleon and was forced to work as a journalist and then as a cotton manufacturer before resuming his career as an economics professor.

Say's Law is a principle stating that, in the long run, the total amount of output produced in the economy generates an equivalent amount of demand for that output. As a result, there can be no such thing as a deficiency of aggregate demand. Although in this view there can be overproduction of particular commodities (that is, in particular industries), overproduction in the economy as a whole is considered impossible. This principle is often reduced to the slogan: 'supply creates its own demand'.

The reasoning behind Say's Law can best be understood by thinking of the economy in terms of flows of goods and services as opposed to money flows – in other words, in terms of a barter economy. Whenever someone produces an additional supply of commodities, they are simultaneously adding to the demand

for commodities. Assume a carpenter producing an additional five chairs and offering them in exchange for other commodities – for example, foodstuffs. In Say's view, that carpenter is increasing demand for foodstuffs through the increased supply of chairs. If other producers do not want additional chairs at the going price, the price of chairs will fall, which is equivalent to a relative price rise of other commodities. Profit-seeking producers will respond to that and will adjust their market behaviour to the relative price changes. Therefore, it can be expected that in the next period the production of other commodities than chairs will increase.

Say's Law can also be illustrated by the circular flow of income. Households receive income equal to the value of goods and services produced. Part of this income they spend and part they save. Thus consumption demand falls short of the total value of production by the amount of savings, but investment demand is assumed to make up this shortfall. As long as investment and savings are equal, aggregate demand will necessarily equal the total value of production. Classical economists argued that savings and investment would always be made equal by changes in INTEREST RATES. Therefore they considered a general deficiency of aggregate demand impossible and full employment was assured.

A long line of the most distinguished economists, including DAVID RICARDO, JOHN STUART MILL and ALFRED MARSHALL subscribed more or less firmly to this view. Though Ricardo was a firm believer in Say's Law, he advanced the idea of technological unemployment. This was a special case that might occur when machines were introduced to replace labour. KARL MARX developed the possibility of technological unemployment further. But he was considered a heretic and technological unemployment was considered an exception to the rule through most of the nineteenth century.

Towards the end of the nineteenth century, however, economic thinking began to change. Economists began to pay more attention to cyclical fluctuations and their causes. W. Stanley Jevons developed the theory that bad

and good harvests caused cyclical fluctuations. Alfred Marshall offered a more sophisticated theory of the role of money in the economy. And Knut Wicksell put forward the distinction between a natural rate of interest determined by technological factors and a money rate of interest that was actually charged. When the natural rate of interest exceeded the money rate, businesses would be able to make greater profits by increasing their investments, which would lead to economic expansion.

Wicksell focused on the problem of saving and investment decisions. He recognized that discrepancies between these decisions might have important effects on the economy as a whole. His followers focused on aggregative problems and the unemployment problem in particular. Although the great crash on Wall Street of 1929 triggered the GREAT DEPRESSION and unemployment rose to a record high, many (neo-)classical economists continued to believe in the theory that a market economy would automatically generate an equilibrium. As late as 1933, A.C. Pigou still insisted that with perfectly free competition there would always be a strong tendency toward full employment.

As the Great Depression became more severe and more prolonged, however, it became quite obvious that Say's Law had lost much of its relevance. JOHN MAYNARD KEYNES attacked Say's Law by pointing out that an additional pound sterling of income need not be entirely spent. He thus argued that real GROSS DOMESTIC PRODUCT (GDP) does not depend on supply (or on what can be produced), but on effective demand (or on what people are willing to buy).

See also:

general equilibrium

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M. PETER VAN DER HOEK

SCALE, ECONOMIES OF *see economies of scale*

Schelling, Thomas C. (1921–)

No twentieth-century economist has had more influence on the scholarly literature about international relations (IR) than Thomas Schelling. His most influential book, *The Strategy of Conflict* (1960), introduced concepts and ways of thinking that infuse the current IR literature. These include commitment strategies, tacit bargaining, strategic interaction, randomized behaviour, agenda-setting, threats, promises, secrecy and revelation. He emphasized the importance of thinking of IR, including war, as a non-zero sum game (see ZERO-SUM GAMES).

Schelling completed his B.A. degree at the University of California, Berkeley, in 1944. He served as a Marshall Plan administrator before completing his Ph.D. in economics at Harvard in 1951. He held positions at Yale University (1953–8), the RAND Corporation (1958–9), Harvard University (1958–90) and University of Maryland (1991–). He served as President of the American Economic Association in 1991.

Schelling has had more influence in the field of international security than in international political economy (IPE), but his impact on the broader field of IR spills over into IPE. His textbook, *International Economics* (1958), focuses on many topics covered by IPE and retains its relevance despite its age. Many of the ideas in this book foreshadow his later work on military strategy and arms control.

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Schengen Agreement

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DAVID A. BALDWIN

Schengen Agreement

The first Schengen Agreement (1985) between France, Germany and the Benelux countries, aimed to abolish border controls between the member-states by 1990. The agreement, an initiative of the French President François Mitterand and the German Chancellor Helmut Kohl, was intended to contribute to the harmonization of visa policies and the coordination of the prevention of crime and terrorism in the light of the planned abolition of border controls in the Single European Market (SEM) to be realized by 1 January 1993. As an administrative agreement, it did not require parliamentary ratification.

Schengen I was followed by an Execution Agreement (Schengen II) in 1990. This agreement was signed and ratified by the parliaments of the original signatories plus Greece, Italy, Spain and Portugal before it belatedly

entered into force on 26 March 1995. Austria, Denmark, Finland, Sweden and the non-European Union (EU) states Norway and Iceland acceded to Schengen after the 1996 enlargement of the EU, leaving Ireland and the United Kingdom as the two EU-members not included. The Treaty of Amsterdam (1997) stipulated the incorporation of the 'Schengen *acquis*' into the EU, but details of this incorporation remain to be worked out.

The implementation of Schengen progressed with some difficulty. By early 1998, nine Schengen countries (the first nine minus Greece plus Austria) had abolished their internal border controls, with two exceptions: the land borders between France and the Benelux and between Italy and Austria.

HENK OVERBEEK

Schumacher, E(rnst) F(riedrich) (1911–77)

E.F. Schumacher was an economist who wrote on alternative economics and agriculture, but also practised farming and journalism, and spent part of his life in business. His most important work is *Small is Beautiful* (1973), where he outlined an alternative form of economic organization based on an ethics in which people matter more than the market. There are two main principles underlying his thought: natural limits to economic growth in the form of finite natural resources, and a critique of the capitalist ethic of CONSUMPTION for consumption's sake (see CAPITALISM). Schumacher argued that consumption should be based on need and that, for mental well-being, human beings need both work and a satisfaction of their basic requirements. Luxurious levels of consumption do not make societies function better; instead they lead to more hectic and stressful lifestyles.

Contrary to liberal thought, which believes in the benefits of FREE TRADE for both welfare and peace, Schumacher believed that large-scale economic organization and dependence

on free trade lead to conflict between societies. Modern society is based on an idolatry of size which is an effect of the growing importance of TECHNOLOGY. However, technological society with its mobility requirement makes people footloose and they lack structures in which they can develop their potential positively; humans need an articulated structure that can cope with a multitude of small-scale units. Economics deals with markets and industrial needs, rather than human needs. Thus fundamental restructuring is needed.

The second great problem that Schumacher addressed was the fundamental incompatibility of a growth-based economic system with a finite ecosystem, especially with regard to energy. Again his solution to this incompatibility was a social reorganization around need-fulfilment rather than ever increasing levels of consumption. Especially with a view to developing countries, he criticized labour-saving machine production and large-scale production, proposing new patterns of ownership and intermediate technology as solutions.

Published in 1973, many of Schumacher's arguments seem slightly dated now. For example, the concern with dwindling oil reserves was not a major priority of the 1990s. However, the main principles of Schumacher's thought have found their way into some of the SUSTAINABLE DEVELOPMENT literature and into the field of ecological economics. Like *Small is Beautiful*, the emerging discipline of ECOLOGICAL ECONOMICS is based on the first two laws of thermodynamics and the principle of entropy. However, its concern is with environmental degradation and inequality in a more abstract and global way than Schumacher, who concentrated more on the ethical distinction between want and need, and had specific ideas about the needs of individuals and societies alike.

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GABRIELA KÜTTING

Schuman Plan

The Schuman Plan of 9 May 1950 marks the beginning of the post-World War II process of INTEGRATION in Europe. On that day, French Foreign Minister Robert Schuman proposed the creation of a EUROPEAN COAL AND STEEL COMMUNITY (ECSC) that would provide a joint authority for the management of French and German coal and steel production. The Schuman Plan was based on a blueprint devised by Jean Monnet in the French Planning Commissariat and revised in the French Foreign Ministry. It built, at least in part, on the experience gained from the International Authority for the Ruhr that had been set up in 1949 and was composed of representatives from Belgium, Luxembourg and the Netherlands (the Benelux countries), along with France, West Germany, the United Kingdom and the United States.

The plan was designed to ensure Franco-German reconciliation and to represent 'a first step in the federation of Europe'. Schuman's proposal envisaged that Germany would become so embedded in an integrated European framework that any thoughts of future aggression would be constrained. Moreover, France declared its willingness to restrict its own SOVEREIGNTY in the fields of coal and steel in order to ensure that German sovereignty would be equally limited. The ECSC thus represented an effort to ensure that the Ruhr would benefit both countries rather than being used solely for narrow national purposes by either country. In this way, it was thought that war would become 'politically unthinkable and economically impossible'.

The plan invited other European countries in addition to France to join in forming an organization that would implement the vision outlined in Schuman's declaration. Five countries responded to the invitation – Germany, Italy and the Benelux countries – and negotiations began a month later. The supranational nature of the plan, however, led the United Kingdom to reject the idea of participation. Nevertheless, the Treaty of Paris was signed on

Schumpeter, Joseph Alois

18 April 1951, the latter becoming the founding document of the process of post-war European integration.

See also:

European Economic Community (EEC); European Union (EU)

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ALISON M.S. WATSON

Schumpeter, Joseph Alois (1883–1950)

Joseph Schumpeter was born in Trest, Moravia, and died at home in Taconic, Connecticut. He is widely regarded as one of the most influential economists of the twentieth century. His works integrate economic theorizing on the matter of economic DEVELOPMENT and innovation with specific sociological issues such as IMPERIALISM and modern democracy. After completing his studies of law and economics in Vienna, Berlin and London, Schumpeter became an assistant professor at the University of Czernowitz (today in the Ukraine) in 1909. During the years 1911 to 1919, he taught as a full professor in Graz, Austria. Public positions as an Austrian minister of finance, as well as private banking activities, proved to be a failure. His professional return to the academic sector led him to the University of Bonn, Germany, in 1925, before he finally moved to Harvard University in the United States in 1932.

Schumpeter's works cover a broad range of topics, but three major motifs can be identified:

- 1 Concern with the dynamics of economic development on which he elaborated extensively in the *Theory of Economic Development*, whose first German edition was

published in 1912, with an English translation issued in 1934. A voluminous book on *Business Cycles*, with extensive historical and statistical material, followed in 1939.

- 2 The integration of economic, sociological and political perspectives, primarily applied to debates on the feasibility of socialism, which is well-documented in *Capitalism, Socialism and Democracy* (1942).
- 3 Lasting interest in the history of economic thought, which is mirrored by the *History of Economic Analysis* (edited posthumously in 1954).

Seemingly paradoxical aspects of Schumpeter's work, such as the almost simultaneous advocacy of formal-analytical and historical-institutional research perspectives, have repeatedly aroused controversies regarding his theoretical position. This discussion still continues. Some scholars have claimed that the theoretical application of equilibrium schemes, for instance, characterize Schumpeter as an essentially neo-classical economist (see NEO-CLASSICAL ECONOMICS) in the tradition of the Walrasian theory, as well as the AUSTRIAN SCHOOL of economics. This is even underlined by a corresponding interpretation of his theory of democracy as a point of reference for new POLITICAL ECONOMY and PUBLIC CHOICE (PC) THEORY.

A different opinion suggests that Schumpeter belongs with the founders of an EVOLUTIONARY ECONOMICS which is conceptually much closer to the traditions of INSTITUTIONALISM and the German Historical School (see HISTORICAL SCHOOL, GERMAN). In contrast to the belief in the unconditional efficiency of free-market competition, Schumpeter pointed to the possibility of superior monopolistic constellations (see MONOPOLY). Moreover, he has been among the very few economists outside the Marxist camp who were convinced of the economic feasibility of a socialist system. Both sides would probably agree on the fact that Schumpeter was also fundamentally influenced by KARL MARX and his vision of CAPITALISM, although Schumpeter's practical

political activities were marked by a firm and determined conservatism.

In order to grasp the actual complexity of Schumpeter's thought, it might be useful to acknowledge that the analytical and the historical aspects of his mode of theorizing together represent an integrated approach to the analysis of modern capitalism. It is appropriate to consider his approach as a quite unique attempt to combine the most promising strands of contemporary theory and methodology in a novel synthesis. In addition, it should here be underlined that Schumpeter maintained a mediating position in the most extensive contemporary methodological controversy – the so-called *Methodenstreit* between the Austrian School of Economists and the Historical School in Germany. In fact, Schumpeter's theory of economic development represents a type of theorizing which cannot be reduced to a concern with abstract universals only, but which accounts for both the economic and the socio-cultural aspects of capitalism in institutional terms. It is thus justified to portray Schumpeter as a theorist of the specificities of the capitalist system and its development – that is, capitalism as a historical phenomenon.

Capitalism as a historical phenomenon

Schumpeter's theory of economic development represents a comprehensive attempt to formulate an integrated theoretical, statistical, institutional and historical analysis of the mechanism and contours of capitalist economic evolution. This particular mode of analysis makes it necessary to complement the 'pure' economic theory of exchange, which is essentially static according to Schumpeter's own verdict, by a historically more sensitive kind of theory that fits the exploration of economic dynamics and thus serves as an explanation of corresponding dynamic economic phenomena like profit, interest and BUSINESS CYCLES. Interest, for instance, is viewed as a phenomenon that needs to be explained in the context of the dynamism of economic development, because it is essentially

connected with the impact of CREDIT and CAPITAL, and thus with the main ingredients of the development process.

Economic development or evolution, in Schumpeter's terms, is marked by a discontinuous pattern of change. The evolutionary process takes the shape of wave-like fluctuations that mirror the cyclical character of economic activity. This specific kind of economic change, with its repeated revolutionizing of the production structures and consumption patterns due to the introduction of innovations, is typical for the modern capitalist economy. Schumpeter's definition of capitalism accordingly refers to a private property economy where innovations are carried out by means of borrowed purchasing power. This amounts to saying that modern capitalism derives much of its historical character from the unique role of the monetary sphere and the related impact of credit-creation.

Modern capitalism is additionally characterized by distinct social and institutional patterns. On one hand, these are constituted by a specific civilization which is built on institutional characteristics, such as the type of RATIONALITY that is related to the use of money as a unit of account or the intellectual attitude and spirit of modern science. The corresponding common drive for quantification and rationalization lends capitalism its historically unprecedented appearance. On the other hand, these typical features of capitalism are necessarily supported by pre-capitalist institutions and social strata. With regard to that aspect, the conceptual focus is on the feudal epoch and the then dominant aristocratic values that remained influential even after the breakdown of the corresponding social structures. Capitalism according to Schumpeter is therefore an economic system whose reproduction depends on its symbiotic amalgamation with the structural elements of different historical epochs.

According to the Schumpeterian approach, certain phases of capitalist development are distinguished: basically described as 'competitive' and 'trustified capitalism'. These phases differ primarily according to their institutional

set-up. This is exemplified, for instance, by the prevailing types of firm organization and entrepreneurial activity. The ubiquitous change of economic structures marks the transition between these phases. It is accompanied by the decomposition of the pre-capitalist and, finally, even the capitalist institutional and social spheres. This results in a tendency towards the decline of the capitalist system which, paralleled by the process of bureaucratization, may lead to the transformation of trustified capitalism into a feasible system of STATE SOCIALISM.

Entrepreneurship, innovation and economic evolution

Schumpeter's vision of the capitalist process is not to be separated from his notion of entrepreneurship as an endogenous source of economic evolution. The basis of Schumpeterian entrepreneurship is constituted by the identification of distinct functions and returns in the economic process. The entrepreneur is defined as that economic subject who develops new combinations of the factors of production – that is, enforces and implements innovations. Within the most general competitive scheme, entrepreneurs set up a new firm financed by credit, proceed with innovations and finally, within the abstract theoretical scheme, receive an entrepreneurial profit which enables them to repay the credit. The function of financing innovations by providing the entrepreneur with purchasing power is carried out by the type of capitalist who acts as a truly risk-taking and thus calculating economic subject.

Entrepreneurship as an economic function is indispensable for the process of development and change, as that process derives its dynamic character as well as its cyclical shape from the repeated introduction of novelty by innovations. Several cases of innovation are differentiated: the introduction of a new good or a new method of production, the opening of a new market, the conquest of a new source of material supply and the implementation of new forms of industrial organization. The distinguishing feature of these technological and

organizational innovations lies in their function of providing the economic system with the opportunity of putting the given means of productive resources to new ends, embedded in the competitive logic of decreasing cost and increasing efficiency.

The Schumpeterian schema allows for stylized differences between ECONOMIC GROWTH and economic development, also denoted as economic evolution. Economic growth should reflect the factors of gradual and cumulative change within an economic system, such as population growth and the resulting changes in the savings rate. In contrast to this, the character of economic development is discontinuous, because major innovations such as the steam engine or the railway have caused an almost complete restructuring of the economic system – that is, a process of 'creative destruction'. Clustered innovations are therefore responsible for the cyclical pattern of the KONDRATIEFF WAVES. Each of these is to be treated as a historical individual that exhibits specific technological and institutional patterns.

This corresponds to the idea that a decisive characteristic of the entrepreneurial function is provided by the spontaneous disruption of the habitual routines of the economic circular flow. The entrepreneur represents the element of initiative, leadership, vision and will power. Entrepreneurs introduce economic novelty and innovations. for their response to changes in the data environment is creative not adaptive. With that kind of unpredictable creative response present, the future course of the capitalist system remains undetermined.

Schumpeter also pointed to the matter of industrial concentration and the increasing dominance of large corporations with a tendency to treat innovations as professional routine procedures in the context of corporate research and development (R&D) activities. This corresponds with the idea that each phase of capitalist development is designed to exhibit specific types of entrepreneurship, such as those of the merchant compared with those of the corporate director. While Schumpeter strictly emphasized the functional aspects of

entrepreneurial action, his notion of entrepreneurship evolved as a highly contextual matter, rooted in the historical diversity of economic forms and modes of behaviour.

Consequently, Schumpeter extended the conceptual range of entrepreneurship not only from the small business entrepreneur to the entrepreneurial agent in the large corporation, but also from the perspective of the single entrepreneurial agent to the organizational intra-firm cooperation of various persons and departments, and even further than that to the entrepreneurial function of certain activities of the state bureaucracy. All of this is due to the idea that it is primarily the enforcement of economic change which matters for performing the entrepreneurial function.

On the subjective level of entrepreneurship, the role of motives is most important. Entrepreneurs appreciate their profits not as ends in themselves, but as means to achieve further ends like, for instance, in attempts to build business dynasties. Entrepreneurs are driven by motives which demonstrate, alongside creative aspects, a sheer will-to-power that goes beyond a hedonistic calculus. It appears, therefore, that entrepreneurs remain strangers in the value-sphere of pure capitalist rationality. They lose their temporary function in the evolutionary process as they are absorbed by the mass of adaptive economic agents.

The state, imperialism and democracy

A most important aspect of Schumpeter's analysis of modern capitalism is its indication of the persistence of pre-capitalist institutions, focusing on the value-sphere of the aristocracy. Schumpeter maintained that all areas of social life exhibit their specific mode of development, based on similar mechanisms like the factor of social leadership.

In order to underline the idea of entrepreneurship as an expression of that leadership aspect in the capitalist system, Schumpeter suggested that the leading organs of a socialist community as well as the chiefs of primitive tribes may perform corresponding functions of change, which are relevant not only in the

economic realm but also in other social spheres. This thesis constitutes the sociological core of Schumpeter's theory of economic development, for it is applied not only to the matter of entrepreneurial innovation, but also to more explicitly sociological matters relating to *IMPERIALISM*, democracy and the state. While Marxists emphasized bourgeois class interests (see *MARXISM-Leninism*), Schumpeter was eager to highlight the unintended consequences of pre-capitalist factors.

The modern territorial state, described as the tax state, was analysed as a historical product of the princely fiscal crisis which induced the development of the state as an organization for raising taxes since the fourteenth century. This organization was inherited by the bureaucracy, and the spirit of patrimonialism still prevails as a result of institutional inertia.

Schumpeter used that type of argument also as an explanation for the phenomenon of imperialism. He maintained that imperialism was neither an outcome of concrete interests, nor a feature of modern capitalism. Quite the opposite view was suggested: imperialism is portrayed as the manifestation of a social attitude which is characterized by the drive for conquest, success, victory and expansion for its own sake. This attitude is not only channelled into entrepreneurial economic activities, but also expresses itself in the political sphere. Imperialism is accordingly defined as the objectless and unlimited drive for expansion, with the state as acting subject. In addition, aggressive nationalism and national rivalry are said to be rooted in the instincts of dominance and war.

It is the absolutist monarchy, with its centralized state and militant policies, that gives birth to the historical atavism of modern imperialism. By contrast, the capitalist rationale is said to be inherently pacifist and anti-imperialist, accompanied by democratization, individualization and rationalization. These are the factors which cause the decline of entrepreneurial action in the economic area, an effect which corresponds to the erosion of traditional habits and motives in the socio-psychological area.

The conflicting patterns of free-trade regimes versus neo-mercantilist policies denote actually existing varieties of capitalist performance; MERCANTILISM is based on the strategy of domination, while FREE TRADE is equivalent to the idea of peaceful and mutually beneficial exchange. Protectionism and related tendencies are grounded in alliances of organized capital and CARTELS as an expression of monopolistic CAPITALISM as a political venture. Schumpeter then denied that trustified capitalism or imperialism were necessary phases or stages of capitalism, as the Marxists suggested. In fact, their motivational essence was said not to be capitalist at all. Schumpeter continued to use this position for argumentation, although he revised the theory in his late works by acknowledging that capitalist economic interests indeed played a role in the development of imperialism.

The notion of the pacifist bourgeoisie persists in his theory of democracy. According to Schumpeter, democracy is not an institutional mechanism for expressing the will of a people, represented for instance by a parliament, but it is a method for the selection of leaders and thus for securing the reproduction of social leadership in the political sphere. The democratic method contains a mechanism of competitive struggles for votes, with politicians as competitors. This means that democracy implies competition among would-be leaders for the vote of the electorate.

Politicians need to exhibit charisma in order to prove political competitiveness. This reflects an aristocratic element again, recognizable from the theory of economic entrepreneurship, for the bourgeoisie as a class is depicted as not being able to provide the public (that is, the masses) with a political vision. In accordance with the thesis that there can be no pure institutional system of capitalism, Schumpeter rejected the idea of a 'pure' bourgeois democracy based on the principles of people's sovereignty and a representative parliamentary order. Once more, the basically elitist concept of social leadership served as the decisive pillar of his theory.

Significance for international political economy

Schumpeter's significance for the debates of international political economy (IPE) may be derived from his theory of innovation and economic evolution. Furthermore, the policy dimension is important for the diverse interpretations and modes of reception that Schumpeter's work has stimulated. On one hand, it has been suggested that the Schumpeterian agenda contrasts with the approach of JOHN MAYNARD KEYNES to demand management and macro-economic regulation (see also KEYNESIAN ECONOMICS). This seems to bring Schumpeter into accordance with NEO-LIBERALISM and SUPPLY-SIDE ECONOMICS which attempt to mobilize the potential of private business entrepreneurship. On the other hand, the Schumpeterian economics of innovation have been reconstructed as a device for intensive policy initiatives. Especially with regard to the analysis of national and regional systems of innovation, the Schumpeterian approach to technological change is used as a counterposition to neo-liberal market optimism.

While these controversies over assessing Schumpeter on theoretical and policy grounds continue, one conclusion suggests itself: Schumpeter's works will inspire further research on technological innovation, organizational change and other aspects of the economic development of modern capitalism.

See also:

advanced capitalism; endogenous growth theory; historicism; long cycles

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ALEXANDER EBNER

SCOPE, ECONOMIES OF *see* economies of scope

second best, theory of

In economic theory, the 'best' is the Pareto optimum – that is, an allocation of resources in which there is no room for improvement that would be acceptable to all involved. In such a state of affairs, no reallocation is possible because no one can be made better off without leaving at least one other worse off. According to WELFARE ECONOMICS, if seven conditions are met (in some versions eight, if we include the absence of transaction costs), then the Pareto optimum is considered to be achieved.

One could imagine that an acceptable alternative would be a situation in which all but one of the conditions for the Pareto optimum are met. However, according to the theory of second best, as formulated by Richard Lipsey and Kelvin Lancaster (1956), if all the conditions necessary for the Pareto optimum cannot be achieved (equilibrium conditions), then the second-best alternative is not necessarily the one in which the remaining conditions for optimality will hold. This means that the fulfilment of most conditions is not necessarily better than the fulfilment of few or none; or even that if one of the Paretian optimum conditions cannot be fulfilled, a second-best optimum situation is achieved only by departing from all other optimum conditions.

This theory has important implications in practice. If we accept that no real-world market can be Pareto optimal, then policies which increase economic EFFICIENCY cannot bring the market closer to the Pareto optimum. Furthermore, some trade or interventionist policies (which would reduce economic efficiency in a state of equilibrium) could prove successful, if they could correct the imperfections or distortions of a market at a cost lower than the benefit to national welfare. On the other hand, when there are multiple MARKET FAILURES in an economy, the best solution for

Second World

a government may actually be non-intervention.

Despite its significance, the theory of second best is neglected by most mainstream economists, mainly because it sounds 'paralysing', but also because it seems tautological.

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ARISTIDES N. HATZIS

SECOND INDUSTRIAL REVOLUTION

see industrial revolution, second

Second World

The term 'Second World' is used to distinguish the geopolitical bloc of countries led by the erstwhile Soviet Union and including its allies in Eastern Europe from the FIRST WORLD countries, which include Western Europe and Northern America, that are characterized by representative democracy, competitive CAPITALISM and free markets. In contrast, the

Second World countries are communist/socialist states with distinct politico-economic models. Second World states were the first to take up seriously problems of DEVELOPMENT in its modern secular sense. They articulated clearly the relationship between economic development and political modernization.

Second World economies were based on the socialist system – with public/state ownership of property and forces of production located within a strictly controlled internal and external market. Centralization of the economy by political and bureaucratic elites based on total planning was a key feature. The emphasis was on industrialization, as in the case of First World states, with a stress on heavy industrial production. The economy was usually characterized by high growth rates.

Politically, democratic centralism with restrictions on opposition and a strong one-party system distinguished the Second World states. Rationalized authority derived from the IDEOLOGY of COMMUNISM and SOCIALISM provided legitimacy. Society was highly urbanized, with a rapid growth of the working class (see CLASS, WORKING) and increase in the white-collar professional class, essentially a result of large-scale technological change. A high degree of social mobility occurred through the occupational hierarchy. Citizens enjoyed high social welfare benefits and social security.

See also:

Third World: Fourth World

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D. PARTHASARATHY

sectoral planning

The term 'sectoral planning' refers to economic policy and planning based on sectors rather than industries. In NEO-CLASSICAL ECONOMICS, 'sector' implies industries engaged in the same market, whereas an institutional interpretation of 'sector' (see INSTITUTIONALISM) includes all of the firms involved in the production of a finished item. It is this definition that accords with sectoral planning. It includes the entire production chain: for example, the car sector might include parts of the metal, engineering, chemicals and plastics industries. A sector may or may not be distinguished by common processes and it will include a range of firm sizes.

Examples of policy based on sectoral planning have been developed at the national and regional level in France (post-1945), and at the local level in the United Kingdom (the former Metropolitan Counties of the 1980s). Sectoral planning is purposeful and selective; its objective is to facilitate and encourage coordinated development within meaningful and relatively self-contained segments of the economy. It requires an in-depth understanding of the nature and requirements of the sector; this implies considerable research and intelligence, and dialogue between policy-makers and industrial actors.

See also:

cultural industries; local economic development (LED)

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ANDY C. PRATT

securities

'Securities' are financial instruments broadly of two types: debt and equity.

Debt securities include BONDS and COMMERCIAL PAPER. These are issued by an enterprise or government seeking funding. They do not involve any ownership interest, but are an obligation to repay the principal and make interest payments at intervals prescribed in the INDENTURE. Where the issuer of debt securities fails to repay as scheduled, they are said to be in default. Debt securities are subject to trading in secondary markets.

The other main type of security, equities, involves an ownership interest (and therefore a liability) on the part of the holder. Although generally easier to issue than debt securities, equity involves at least the potential for loss of control of the corporation through the issuing of shares. Equities are freely traded on STOCK MARKETS. Recently, non-traded financial assets such as loans and credit-card receipts have been subject to SECURITIZATION in order to capture the potential benefits offered by trading in securities.

TIMOTHY J. SINCLAIR

Securities and Exchange Commission (SEC)

Established in 1934 in response to the financial scandals of the GREAT DEPRESSION, the Securities and Exchange Commission (SEC) supervises US SECURITIES markets. It seeks to ensure full information disclosure, regulate conflicts of interest, prevent malpractice and ensure fairness in the markets. Principally staffed by lawyers, economic EFFICIENCY is not a central objective of its activities.

TIMOTHY J. SINCLAIR

securities firms

Securities firms facilitate the issuing (in primary markets – see MARKETS, PRIMARY) and trading (in secondary markets) of securities (such as bonds and stocks). A key function

securitization

provided by securities firms is underwriting – guaranteeing to an issuer that all the securities will be sold.

During the 1960s, a vigorous market developed in eurobonds (bonds denominated in a currency that differs from the nationality of the issuer), facilitated by a relatively small community of international securities firms. Common norms and practices were sustained by the need for firms to cooperate in bond syndicates: issuers were very large corporations, governments or international organizations and their bond issues were too large for single firms to handle. The 1980s saw a period of dramatic change for securities firms. First, markets in euroequities mushroomed. Second, a series of rapid DEREGULATIONS, initiated by the Big Bang in London in 1986 and repeated in other countries, began to eliminate the protection from banks and foreign firms that domestic securities firms had enjoyed. Third, there was a striking ‘institutionalization of investment’ – mutual and pension funds enhanced the power of investors relative to securities firms and, in some cases, would bypass securities firms entirely and work directly with the issuer. Fourth, banks became increasingly involved in securities markets in both the traditional business of securities firms and in new derivatives.

Because of the intangible, interdependent, risky and high-cost nature of transactions in international securities markets, trust and control are critical issues. Traditionally this was accomplished by an informal limiting of the market to a restricted number of large securities firms and issuers. Self-regulatory institutions such as the INTERNATIONAL FEDERATION OF STOCK EXCHANGES (FIBV) and the INTERNATIONAL SECURITIES MARKETS ASSOCIATION (ISMA) have also been important. Inter-state regulatory cooperation has occurred at the INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO).

TONY PORTER

securitization

The term ‘securitization’ describes two different FINANCIAL INNOVATIONS of the early 1980s:

- 1 The transformation of non-marketed into marketable assets by packaging bank loans into SECURITIES.
- 2 The tendency for firms to borrow at international CAPITAL MARKETS by selling securities, instead of taking out bank loans.

The main reasons for the (more important) second variant are:

- 1 the increase of regulatory costs for banks,
- 2 the LIBERALIZATION of security markets,
- 3 conflicts of interest between investors and their banks, and
- 4 reputation effects and CREDIT RATING, which substitute for the monitoring by banks.

The main results have been the disintermediation and GLOBALIZATION of financial markets.

See also:

commercial paper: intermediation: money markets

GERALD SEIDEL

security, economic

‘Economic security’ is a murky concept that is increasingly prevalent in policy and academic discussions. It loosely encompasses three concerns: (1) countries need to maintain a strong enough economic base to support military spending requirements; (2) countries need to protect their citizens from international economic shocks and to ensure access to critical resources and technologies; (3) countries need to provide an adequate standard of living to their citizens, which may involve the maintenance of domestic production in ‘strategic’ industries. Different analysts and policy op-

tions address each of the three types of economic security.

The first economic security definition has close ties to traditional national security policies. Rulers' disposable income, which depends on tax receipts from a productive economy, has always determined the amount of military capability that can be purchased. Capital and labour invested in force structure and weapons research are diverted from productive civilian pursuits. Peacetime military forces require a long-term stable level of investment – a steady drag on productivity. Wartime activities require additional short-term funding for operations (resources consumed by the war). In the age of total war, national military mobilization diverts additional workers from production of consumer goods and additional capital from long-term investment. Countries that run out of money for military expenditure lose wars (an example being Spain's collapse in the Thirty Years' War); countries that lack the economic base to maintain their peacetime level of military expenditures often collapse from within (the Soviet Union being a good example).

The second economic security definition focuses on external factors that can intermittently affect prosperity – just as military security focuses on protection from wars that intermittently threaten a country's territorial integrity. Marxist theories of IMPERIALISM (see MARXISM–LENINISM) take this definition of economic security to its logical extreme when they argue that military adventures are stimulated by the need to conquer foreign markets as a dumping ground for capitalist industries' overproduction. According to this view, military security is subordinate to economic security, and wars start when the business cycle threatens influential corporations' profits.

Realists sometimes also justify military interventions for economic reasons, but from a more defensive perspective than the Marxists. The state of economic security, in this view, is defined by immunity from external economic shocks and foreign economic COERCION. Realists want to preserve access to critical raw material supplies to prevent wartime shortages

and to prevent foreign leaders from suddenly raising prices on essential imports, which might trigger a domestic recession. Strategic stockpiling of resources complements the realist economic security prescription of military intervention in preserving access to supplies. Liberals (see LIBERALISM), on the other hand, recommend policies to shift from dependence to INTERDEPENDENCE as a response to economic security threats: the threat of retaliation under interdependence may deter attempts at economic coercion.

Oil is the obvious example of a key resource for economic security, but materials like uranium, rubber and bauxite have also been called vital. Similarly, access to particular technological capabilities is often treated as a necessary component of economic security – highlighted, for example, in the lists of 'critical technologies' that circulated among US policymakers in the late 1980s. Japanese security policy may also be strongly influenced by the desire to promote technological indigenization.

The third economic security definition considers a country's long-term prosperity – the base rate of ECONOMIC GROWTH rather than the variance in prosperity addressed in the second definition. At one extreme, economic security might require citizens' access to a minimum level of 'basic human needs', including adequate housing and food supplies. This definition brings the economic security discussion most directly to the level of the individual.

At the national level, a more moderate definition still envisions the protection of long-term prosperity as the key measure of economic security. Competitiveness, particularly in sectors with ECONOMIES OF SCALE, has been considered an appropriate focus for policy in all but the most extreme LAISSEZ-FAIRE governments. According to STRATEGIC TRADE THEORY, government policies that help domestic industries in strategic sectors can increase real national wealth by shifting rents from foreign competitors. Without economic security policies in these sectors, foreign governments might use strategic trade policy to extract rents from the domestic citizenry, reducing prosperity – for example, through

security, global

the MONOPOLY pricing of high-tech products. However, because concerns about domestic firms' competitiveness tend to rise and fall with the business cycle, it is difficult for democratic governments to maintain political support for constant vigilance on this type of economic security. Competitiveness policy-making may also be subject to domestic RENT SEEKING, which can cause economic security policies to reduce rather than enhance long-run prosperity.

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EUGENE GHOLZ

SECURITY, ENVIRONMENTAL *see*
environmental security

security, global

Global security is usually incorrectly imagined solely in military terms, and in relation to states, as the maintenance of international peace and order among states on a worldwide scale by military and diplomatic means. However, military security of this sort (and the security of states and transnational/international organizations) forms only important aspects of a much wider range of issues encompassed by the term 'global security'.

Global security can take many other forms, including economic, environmental, personal and information security. Each of these is significant for the conduct of international politics and international economic relations. Economic security (see SECURITY, ECONOMIC) refers to the protection of systems of production and exchange, of economic resources, and of business interests. Environmental security (see ENVIRONMENTAL SECURITY) refers to the protection of the ecological context of human action, including the atmosphere, climate, seas, food supply (food security) and land. Personal security includes not merely the ability to exist free of physical danger, but also covers freedom of movement, action and expression, and freedom from surveillance. Information security refers to the protection of knowledge and

intellectual property, information exchange and processing systems, and access to information. These areas need not suffer military threat for their security to be considered endangered. Nor need responses to these threats necessarily be military in form. There are, therefore, 'threats without enemies' in the maintenance of global security. These threats are probably increasing at the beginning of the twenty-first century.

Changes in the range and scale of human activity, and in technologies, have transformed each of these areas of global security since 1945. The GLOBALIZATION of economic relations, and growth of the MULTINATIONAL CORPORATIONS (MNCs) and international financial markets, has produced new problems for global economic security. The recognition (especially from the 1980s onwards) of threats posed by climate change, pollution and the dangers of nuclear and biological accidents, have highlighted the new dilemmas for environmental security. Increased global travel, reliance on TELECOMMUNICATIONS and new use of information technology have affected personal and information security, the latter being especially at risk from new techniques of 'information warfare': the deliberate attempt to command and control information as a means of defence or attack.

Even in the area of military security, the end of the COLD WAR, enduring nationalist and ethnic tensions (see NATIONALISM), and the military use of new technologies have both enhanced and created threats. Especially of note are the increase in terrorism, intra-state warfare and (as above) the use of information technology for military purposes, alongside the risk of greater proliferation of nuclear, biological and chemical weapons. These changing forms of warfare, the decline of the USSR and the United States, and various other threats to global security have led many to conclude that the post-Cold War world is less secure than that of the period 1945–89 and that no single state can any longer provide for its own security or for that of its citizens. Many analysts have doubted whether the state is any longer the greatest threat to, or provider of,

global security and have looked to an enhanced role for INTERNATIONAL ORGANIZATIONS (IOs) and international cooperation in meeting these new challenges.

See also:

global warming

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KEN DARK

SECURITY, INTERNATIONAL *see*
international security

security, politico-military

'Security' is the perception that one is free from physical threat: it is freedom from fear. More broadly, security is freedom from threats to the core values of a person or group. For states,

this means protecting their territorial integrity, economic vitality and way of life (however that may be defined).

Security is an inherently subjective and contested concept, varying from one individual or group to the next. Different governments and leaders perceive security differently, and they conceive of different ways to obtain and maintain that security. Security can have political, economic, societal, cultural, ecological and broadly military components. Most fundamentally, politico-military security is the survival of the state and/or its leadership, and the military means by which that survival is secured.

In modern democratic states, survival is usually associated with maintenance of the system and institutions of the state, not individual governments. Thus UK and US governments have justified war to defend democracy and their respective governmental institutions, not to defend (say) a Conservative government in the United Kingdom or a Democratic one in the United States. In previous centuries and in extant authoritarian states, security was and is defined by leaders in terms of their own continuation in power and their survival: *l'état, c'est moi*. (It is also the case, of course, that leaders of democratic states – such as US President Richard Nixon – have been accused of equating their personal survival with that of the state.)

The 'national security' of states is secured or thought to be secured by the maintenance of and (if deemed necessary) the use of military force and, in authoritarian states, paramilitary and police force. These 'national defence' forces are nominally directed at external threats, such as deterring or responding to attacks from unfriendly neighbours. Military forces may also be used, however, against domestic enemies, including at times unarmed civilians demonstrating opposition to the regime.

A reliance on the more traditional conceptions of security that focus on fear and military preparedness may be counterproductive, especially in contemporary world affairs. Barry Buzan, for example, has suggested that 'exces-

sively self-referenced security policies' are outmoded and that states would be better served by embracing the security requirements of neighbouring communities (Buzan, 1983: 214–42). This of course begs the question of how much states can disregard their own narrow interests in an anarchic international environment. International cooperation, particularly in the areas of trade and economics, suggests that this is possible. For example, in the context of the WORLD TRADE ORGANIZATION (WTO), states acknowledge that by considering the economic security of other states they can, in the long term, bolster their own economies and thereby the interests that depend on economic vitality.

See also:

security, economic; environmental security; security, global; international security

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PAUL G. HARRIS

Seers, Dudley (1920–83)

Dudley Seers was a pioneer of DEVELOPMENT economics causing numerous shifts in development paradigms. It is a sad irony that he died prematurely while preparing a WORLD BANK-sponsored book on 'Pioneers in Development' in which, by rights, he should have been

prominently featured. His particular strengths were country studies with realistic insights into the main structural features and bottlenecks of the countries concerned and policy-advice based on these insights – hence he is classified as a structuralist (see **STRUCTURALISM**). Specially influential were his studies of Cuba (with Richard Jolly) and of Colombia and Sri Lanka (then Ceylon), the last two under the auspices of the International Labour Organization World Employment Programme. It is said that he worked in thirty-five countries spread throughout Asia, Africa and Latin America. In fact, we may also add Europe, to which he turned his attention in later years as part of his advocacy of strong regional blocs preserving national and cultural identities, rather than full internationalism; it also reflected his strong belief that the developed countries (the ‘special case’ of a minority of humankind) had much to learn from the ‘general case’ of the poorer countries.

Seers’ theoretical achievements can only be briefly listed: his discovery, based on his study of Trinidad, of what was later called the **DUTCH DISEASE** (that is, the dangers of a sudden export boom in a single commodity); his ‘discovery’ of the informal sector that had previously been considered parasitic and a case of disguised unemployment and consequently excluded from national income statistics; his work as a bridge between the Latin American centre-periphery model and dependency and other Western thinking; his focus on social indicators and distribution rather than the rate of growth in **GROSS NATIONAL PRODUCT (GNP)**.

Seers was the first Director General of the Economic Planning Staff of the newly created Ministry of Overseas Development in 1964. In the 1960s, he also became the chief founder and then director of the Institute of Development Studies (IDS) at Sussex University, proving to be an inspiring team leader and establishing a high international reputation for the IDS.

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HANS W. SINGER

segmented capital markets

‘Segmented capital markets’ is a term used to describe non-integrated markets in long-term capital instruments, such as equity and bonds of more than one year maturity (see **BONDS**; **EQUITIES**). Segmentation occurs because of national legal restrictions on the flow of capital, differential market risks (including credit, exchange and inflation risks), transaction costs or simple unawareness of investment opportunities. It results in a group of investors consistently utilizing only a subset of the total number of markets potentially available. In the post-war period, **CAPITAL MARKETS** in the developing world have generally been assumed to have been segmented from more developed markets, but evidence suggests this segmentation is decreasing as governments liberalize (see **LIBERALIZATION**), seek international funding and allow domestic capital to use alternative markets.

Non-integration implies a qualitative systemic disjuncture between different markets, leading to differential price and risk dynamics, a fact which has advantages for international portfolio-building since different systemic risks can be balanced within a portfolio. Decreasing segmentation of markets through trade flows, **ARBITRAGE**, technological innovation, cross-listings, regional agreements and investor psychology will lead to the increasing integration of risk, as well as prices.

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STEPHEN GREEN

seigniorage

'Seigniorage' is the revenue governments earn from the creation of money. Central banks earn seigniorage from issuing paper money and from requiring private banks to deposit reserves at the central bank for which they receive little or no interest. The revenues from seigniorage can be measured either as the increase in currency in circulation and reserve deposits (minus any interest paid on those reserves) or as the savings in interest payments the government receives from not having to pay market INTEREST RATES on cash in circulation and reserve deposits. This 'monetary' seigniorage does not always translate into 'fiscal' seigniorage – that is, government revenues – because central banks may use seigniorage revenues to subsidize credit to certain borrowers or spend it on their own projects.

Governments can increase seigniorage by printing money and by requiring private banks to maintain larger reserves at the central bank. However, printing money is inflationary and seigniorage, in this case, is often called the 'inflation tax'. The value of seigniorage to the government rises with INFLATION, since inflation causes the volume of cash in circulation and the volume of reserve deposits to grow more quickly.

The GLOBALIZATION of financial markets has made it more difficult for most governments to raise revenues from seigniorage. The increased threat of CAPITAL FLIGHT discourages governments from printing money in order to finance spending. LIBERALIZATION of capital movements creates international competitive pressures on governments to reduce reserve requirements imposed on private banks, because these requirements constitute a significant cost of doing business that can be avoided by shifting activity to more loosely regulated offshore markets. On the other hand, the issuers of international reserve currencies can increase their seigniorage revenues as a result of the willingness of foreigners to hold their cash or to hold assets denominated in their currencies at below-market interest rates.

The United States has been the largest beneficiary of 'international' seigniorage, most notably when the dollar (see DOLLAR, US) has become widely used in countries experiencing rapid inflation or political instability (for example, 'dollarization' in some developing countries and in Russia) and when US cash is used in illicit international commerce (for example, the drug trade). International seigniorage became a political issue in the 1960s, when some foreign governments (led by France) decried the ability of the United States to run repeated BALANCE OF PAYMENTS deficits financed by the willingness of foreigners to hold dollars. This ability was alleged to enhance US power and ease the foreign expansion of US MULTINATIONAL CORPORATIONS (MNCs).

See also:

foreign exchange reserves; offshore finance

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MICHAEL C. WEBB

self-help

In domestic society, individual persons can turn to the state, and specifically to the police, for the protection of their physical well-being. They need not rely only on themselves for physical security. In contrast, the international system does not have an overriding supranational authority analogous to the police in domestic societies. States cannot rely on others to protect them from the use of force against

them, but must instead protect themselves from all threats, present and potential. Security can come only from self-help. Realist theorists (see **REALISM**) argue that in a self-help system, a balance of power will develop in which states group together to protect themselves from strong neighbours. Paradoxically, in undertaking efforts to protect themselves in this way, states build up defences that are perceived as threats by other states, thus contributing to a spiral of military build-ups referred to as the security dilemma. Liberal theorists and liberal internationalist politicians and scholars (see **LIBERALISM**) have advocated alternatives to the self-help system to get around the security dilemma. They have advocated collective security institutions (for example, the League of Nations and the United Nations), where members agree to defend any other member threatened by force. Alternatively, some theorists point to the advantages of a global hegemon willing to take on the burdens of international security (see **HEGEMONY**; **INTERNATIONAL SECURITY**). This begs the question of which state should take on that role and whether that state can be trusted to uphold the interests of all.

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PAUL G. HARRIS

semiconductor industry

The semiconductor industry, which manufactures the microelectronic devices that form the basis for modern computing, communications and weapons systems, is characterized by rapid innovation, fierce competition and high costs for **RESEARCH AND DEVELOPMENT (R&D)** and capital equipment. These factors have resulted in numerous interventions by governments to create or sustain national advantage. The

industry's size and growth rate make for high stakes in international trade and politics: worldwide industry revenues reached nearly \$20 billion in 1980, \$50 billion in 1990 and \$144 billion in 1995. Revenues are forecast to be \$220 billion by 2001. Japan and the United States have been at the centre of policy activity and conflict.

In Japan, aggressive government support for the semiconductor industry began in 1976, when the government funded the Very Large Scale Integration project, whose budget amounted to 40 per cent of all semiconductor R&D in Japan in the late 1970s. The project greatly improved the semiconductor manufacturing technology of Japanese firms and established Japan's dominance in the world market for memory chips in the 1980s, when its market share reached 70 per cent.

In the United States, the industry's early years were marked by extensive Defense Department support via procurement; the military purchased 50 per cent of US semiconductor output in the early 1960s. As the commercial market grew in size and sophistication in the 1970s and 1980s, the importance of the government support declined. With Japan's challenge in the 1980s, however, the US government and industry developed the SEMATECH consortium in response. Funded half by the government and half by industry, SEMATECH spent approximately \$1.8 billion between 1988 and 1996 on manufacturing technology development. SEMATECH improved manufacturing quality in US semiconductor firms and contributed to the industry's resurgence in the 1990s.

The history of government interventions and shifting market shares led to trade conflict between the United States and Japan and, eventually, the 1986 Semiconductor Trade Arrangement (STA). In exchange for the United States dropping trade cases alleging Japanese 'dumping' of chips at below-cost prices, Japan agreed to sell chips at prices no lower than 'fair market value' and to further open its markets to foreign firms. Japan thus pledged to meet a target of 20 per cent foreign market share in its semiconductor market by

Semiconductor Research Corporation (SRC)

1991. The STA's targets were attained: foreign market in Japan increased from 9 per cent in 1986 to nearly 30 per cent in 1991. The agreement's departure from principles of FREE TRADE was, however, criticized as 'managed trade' between two countries.

With maturing manufacturing technology for memory chips, there has been market entry: Taiwan and South Korea collectively now have approximately 25 per cent of the market for memory. Aggressive investment in semiconductor fabrication capacity by Taiwan and Korea contributed to a severe slump in the price of memory chips in 1997 and 1998. In higher-end chip markets, such as integrated circuits and digital signal processors, US producers continue to lead.

Going forwards, the industry must manage conversion to chip manufacturing on 300 mm silicon wafers (from 200 mm), a \$10–20 billion re-tooling effort. To address this, SEMATECH has established the I300I consortium – an international project to develop the new tool set for 300 mm wafer fabrication. Japanese firms opted not to join I300I and, with government assistance, created a parallel 300 mm enterprise called Semiconductor Leading Edge Technologies (SELETE).

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JOHN HARRIGAN

Semiconductor Research Corporation (SRC)

The Semiconductor Research Corporation (SRC), one of North America's largest co-operative research consortiums, seeks to promote the competitiveness of its SEMICONDUCTOR INDUSTRY. In 1982, increased technological competition from Japanese companies led the US Semiconductor Industry

Association to form the SRC. The SRC focuses on the industry's long-term technological needs, enabling its members to concentrate on product-oriented RESEARCH AND DEVELOPMENT (R&D). It funds much of the industry's basic research at North American universities, promotes TECHNOLOGY TRANSFER from these projects, builds links between research groups and prevents skills shortages by funding graduate students. By 1998, over sixty-five US and Canadian companies and government agencies were members. Although business members provide the vast majority of SRC funding, the consortium has received government support through TECHNOLOGY POLICY programmes and grants.

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CHRISTINE MARGERUM HARLEN

semi-periphery

The use of the term 'semi-periphery' can be traced back to writings by LENIN on IMPERIALISM, but today it is mainly associated with the WORLD-SYSTEMS THEORY of IMMANUEL WALLERSTEIN. In his *Imperialism: The Highest Stage of Capitalism* (1939 [1916]), Lenin referred to 'semi-colonial' states, which are subject to the dominance of finance capital even though they have political independence. Although in this work Lenin largely took the view that imperialism would hasten capitalist development in the colonies and semi-colonies, his argument also contained the seeds of a different approach. This was taken up by the Third Communist International after Lenin's death. At the Sixth Congress (1928), it was argued that imperialism hindered capitalist development because it promoted a class alliance between imperialism and the dominant

non-capitalist classes of the colonies and semi-colonies. The strategic solution was to support the progressive national capitalist class against imperialism and backward dominant classes.

Although underdevelopment theory rejected this strategy (see UNDERDEVELOPMENT THESES), it continued to argue that imperialism hindered the development of the productive forces in the periphery. In the 1950s and 1960s, writers such as PAUL BARAN and ANDRE GUNDER FRANK argued that the world capitalist economy was divided into metropolitan and satellite regions, the former of which developed by extracting the surplus of the latter. Wallerstein referred to the two regions as core and periphery (see CORE-PERIPHERY MODEL), but added a third subsector of the world economy: the semi-periphery. He argued that this 'represents a midway point on a continuum running from the core to the periphery' (Wallerstein, 1974: 102) and regarded it as a kind of buffer zone between exploitative core-periphery relations, alleviating the antagonisms between these sectors. The place occupied in this hierarchy is determined by the strength of the state machine, so that core states use their power to underdevelop the weak states of the periphery. His argument lacks clarity, but it appears that the core states deliberately create and preserve a semi-periphery to secure their interests.

While there are hierarchies in the world system, Wallerstein's characterization of these and his use of the term 'semi-periphery' are unconvincing. In particular, a global hierarchy appears to be more an *effect* of international capital accumulation, rather than its *cause*. Wallerstein's explanations for movement within the three-tier hierarchy of core, periphery and semi-periphery are forged purely at the level of theory – a state moves up or down the ladder according to the 'logic of the system'. But this is a poor *ad hoc* explanation for very real changes, and a functionalist one at that (see FUNCTIONALISM). It is also ahistorical, as it assumes the existence of a world capitalist system that has barely changed over the last 500 years.

One important attempt, influenced by world-systems theory, has been made to explain the rise of the NEWLY INDUSTRIALIZED COUNTRIES (NICs) from the 1960s onwards (Frobel, Heinrichs and Kreye, 1980). The East Asian NICs in particular are identified as a new semi-periphery. Unlike Wallerstein's sweeping generalizations, this account has the merit of being sensitive to real historical processes, but it still suffers from the weaknesses of its parent theory. The basic explanation is that from the late 1960s, core capital (in the hands of transnational corporations (TNCs) – see MULTINATIONAL CORPORATIONS (MNCs)) relocated investment from core to peripheral areas in order to take advantage of cheap labour. However, any convincing account of the rise of the NICs would have to examine the particular conjuncture of both local and global factors, and in particular the role of the state and local classes in promoting industrialization. Moreover, it would have to account for the success of some East Asian countries in moving from the production of low-value, labour-intensive goods into high-technology, capital-intensive goods. Any account which simply focuses on the needs of the core ignores the role of local agency in changing the world system, and the very real contradictions (as opposed to an omnipotent structural logic) involved in this process – for instance, the deficits that many core countries face in their trade with some East Asian countries.

In its world-systems guise, then, the concept of semi-periphery is not very useful. For it to carry some analytical weight, it has to be more sensitive to the concrete situations of UNEVEN DEVELOPMENT in the world today.

See also:

dependency theory; New International Division of Labour (NIDL)

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RAY KIELY

Sen, Amartya Kumar (1933–)

Amartya Sen – an Indian economist, philosopher and the Master of Trinity College, Cambridge – was made the 1998 Nobel laureate 'for his contributions to WELFARE ECONOMICS'. A 'practitioner of economics with a human face', he was successful in applying his theories to the WELFARE of the unfairly disadvantaged and in popularizing his work without compromising its quality.

Sen studied economics and philosophy at the Presidency College in Calcutta and at Trinity College in Cambridge, where he obtained his doctorate in economics in 1959 (working on

the choice of appropriate production technologies in developing countries). He taught economics at Cambridge (1957–63), New Delhi University (1963–71), London School of Economics (1971–77), Oxford (1977–88) and Harvard (1989–98), before returning to Cambridge as Master of Trinity College. He has served as president of the American Economic Association and the Econometric Society, and has been the recipient of many honours and awards.

The Nobel prize was awarded to him mainly for his early work on social choice theory and collective decision-making in democracies. This early work is decisive for Sen's contribution to development economics, which are closely intertwined with his work on collective choice.

The problem of collective decision-making in a SOCIETY that is not homogeneous and in which there are sharply contradictory views on various issues is solved in democracies by way of the majority rule. However, this rule cannot guarantee a consistent ranking of preferences for different social states, since it encourages strategic behaviour as well as manipulations of voting procedures. This could create 'intransitivity' and thus an outcome that has not been approved by the majority. According to the impossibility theorem of KENNETH ARROW, no collective decision system (that is, voting system) can be both rational and egalitarian, which means that no voting system can guarantee truly democratic decision-making. The paradox of voting leads to an inconsistent ordering of preferences and consequently to decisions that do not coincide with the actual choices of the people.

Since the mid-1960s, Sen has been attempting to solve this problem, especially in his celebrated *Collective Choice and Social Welfare* (1970; this contains some previously published work). The problem for Sen is that collective decision-making cannot lead to a rule that respects the individual rights of everyone. This could be achieved only by consensus. But a unanimity rule is not practical. Another solution would be to place restrictions on the voters' preferences – for example, delineating a 'protected sphere of rights' for each individual (following J.S. MILL and in accordance with

John Rawls). However, the only way for a majority rule to lead to consistent results is to accept interpersonal utility comparisons. If the utility which individuals attach to different alternatives can be compared, then we can have a consistent social choice. Sen supported (siding with Rawls) an 'extended sympathy' model – that is, the comparison of the utilities of two different persons, using the views of a third person as the measurement device. Although this method could be characterized as overly subjective, it is also powerfully appealing (as the abundance of literature following the work of both Rawls and Sen suggests).

Sen applied his social choice theories to the construction of indices for the measurement of welfare and inequality, especially his famous 'poverty index'. The methodological difficulty was again the impossibility of interpersonal comparisons of welfare. Sen once more cut the Gordian Knot by thoroughly discussing the requirements for welfare: income (not as a nominal benefit but as empowerment), life expectancy, average levels of literacy and education, and so on. He criticized the 'poverty line' (per capita income) approach as one-dimensional and misleading, and called attention to the fallacy of measuring economic growth in purely quantitative terms. His work is now considered fundamental to the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP) and the preparation of the annual UN human development report, as well as the Human Development Index.

Sen's work on famines best exemplifies his approach. Sen (who witnessed the effects of starvation in his native India) challenged the mainstream view that famines are caused primarily by a shortage of food. After studying famines in India, Bangladesh, Ethiopia and the Sahara, he showed that famines are related to the actual opportunities of different social groups. A number of social and economic factors (especially unequal entitlements) could limit such opportunities, thus creating or intensifying starvation.

Sen's work on economics has guided his approach to political philosophy. His theory of

justice attempts to unify EFFICIENCY and EQUALITY, in spite of mainstream economic theory. For Sen, equality is the development of people's capabilities, which requires equality in moral respect. According to Sen, developing economies need to focus on 'social opportunity building'. Sen believes in redistribution, but only to the extent that opportunities are offered to people who would otherwise not stand a chance. He is thus opposed to simple-minded 'equal distribution of goods' theories. A balance of social, political, market and procedural opportunities, together with 'protected freedoms' for individuals, are crucial for overall social progress.

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ARISTIDES N. HATZIS

senile-industry protection

The term 'senile-industry protection' refers to the temporary use of trade barriers to assist the adjustment of declining industries to import competition. Robert Gilpin (1987) notes the popularity of senile-industry protection arguments in advanced industrial countries faced with increasing imports during the early 1980s. In contrast to explanations linking protectionism to political pressure, the term implies that a case for assistance to declining industries can be made based on economic theory. In this sense, proponents of senile-industry protection seek to obtain the legitimacy often ascribed to economic arguments justifying INFANT-INDUSTRY PROTECTION. The concept of senile-industry protection in theory and in practice, however, has been problematic at best.

The theoretical argument for senile-industry protection hinges on the concept of MARKET FAILURE. Specifically, the argument holds that labour markets in advanced industrial countries are too inflexible to cope with imports. Different versions of the argument point to the threat posed by rapid surges of imports, broader shifts in COMPARATIVE ADVANTAGE or the unfair trade practices of developing countries. Although acknowledging that imports provide benefits, proponents of senile-industry protection contend that these benefits are outweighed by the extensive costs of ADJUSTMENT imposed on declining industries.

Thus temporary import protection is necessary to ease the costs of adjustment. In this sense, senile-industry protectionism can be justified according to what economists have termed 'the theory of second best' (see SECOND BEST, THEORY OF). Market-distorting strategies such as protectionism should be avoided; however, protectionism can be a second-best

strategy if it serves to offset existing problems of market failure at home or abroad.

The theoretical argument for senile-industry protection faces at least three major problems:

- 1 Market failures are often difficult to identify. In addition to accurately determining the extent to which market failures exist, the senile-industry argument would have to determine the extent to which such failures are responsible for the problems faced by the declining industries seeking relief.
- 2 Protectionism is not necessarily the second-best solution to problems of market failure and may, in fact, be a distant third-best alternative. Paul Krugman and Maurice Obstfeld (1988) exemplify this objection with their argument that domestic subsidy programmes for declining industries can address the transition costs found in inflexible labour markets with less market disruption than import restrictions.
- 3 The nature of the adjustment to be undertaken by the declining industry remains underspecified. The senile-industry argument fails to explicitly state whether the declining industry is to be phased out or revitalized, in whole or in part, through the adjustment process. As a result, the temporary protection can become indefinite, lasting until the industry returns to some unspecified level of viability or until it ceases to exist.

Senile-industry protection in practice has been problematic as well:

- 1 The parameters of a senile industry and the ramifications of senility remain unclear. For example, textiles and steel have long been touted as declining industries in advanced industrial countries and have been cited as meriting relief. Both industries, however, raise questions for the utility of the term 'senility' and its implication of inevitable decline. Neither industry has been phased out, nor is in the process of being fully eliminated by market or state forces. Each is distinguished by subsectors in retrenchment and declining competitiveness, as well as by

the development of production capabilities in new, high value-added market niches (such as carbon fibres and speciality steels).

- 2 Another problem lies in the linkage between protection and industry adjustment. Where protection for senile industries has taken place, the provision of import restrictions rarely has been made conditional on either industry restructuring or phase-out. This pattern has provided support to critics of the senile-industry protection argument who note that protection is more of a reflection of political pressure than of economic merit.
- 3 Assistance to declining industries often has been more permanent than temporary, reflecting political pressures and distortions caused by the protection itself. In textiles, for example, extensive QUOTA schemes embodied in the temporary Short- and Long-Term Arrangements of the 1960s gave way to the MULTI-FIBRE ARRANGEMENT (MFA) from the 1970s through the 1990s. Under the URUGUAY ROUND agreement, these restrictions were scheduled for conversion into TARIFFS over an additional ten-year period. Similar (albeit less extensive) patterns of protection have taken place in sectors including steel, footwear, consumer electronics and automobiles.

Senile-industry protection is thus an attempt to justify import relief for declining industries in advanced industrial countries on economic rather than political grounds. Theoretical problems with the argument and past practice suggest that the attempt has fallen short of this aim.

See also:

voluntary export restraints (VERs)

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H. RICHARD FRIMAN

sensitivity, economic

In a general sense, economic sensitivity signals some level of responsiveness of an economy to developments that might take place inside the economy or within the wider world economy. Greater precision has been given to this notion by locating the definition of sensitivity within relationships of interdependence. ROBERT KEOHANE and Joseph Nye, in their seminal work *Power and Interdependence*, propose that:

Sensitivity involves degrees of responsiveness within a policy framework – how

quickly do changes in one country bring costly changes in another and how great are the costly effects.

(Keohane and Nye, 1977: 12)

A comparable definition might be applied to developments taking place within an economy and having potentially significant effects on some part, or the whole, of the rest of the economy. Such sensitivity is a function of the speed and level of any costly impact on a society, generated by any development(s), before there is time and opportunity to introduce new policies that might ameliorate the situation. The seriousness of any condition of economic sensitivity is thus signalled by the level of costs entailed. Economic sensitivity, in this sense, is thus an objective condition and can be quantified by observers, within and from outside the country in question.

Such an 'objective' view of economic sensitivity does not, however, capture important aspects of the idea as it is generally understood. There are many instances of important developments in public sentiment and/or public policy-making in which the significance of those developments, either internal or external, may be either underestimated or exaggerated. Prior to the oil price shocks and embargoes of the 1970s, there was relative complacency about the level of exposure of Western economies to interference with oil prices or supplies. 'Subjective sensitivity' was thus low on this issue. Once the oil shocks of 1973-4 and 1979 had wrought their economic havoc, however, levels of anxiety about energy supplies rose dramatically throughout Western societies. Such heightened subjective sensitivity stimulated a wide range of new policy initiatives to reduce energy requirements and/or diversify sources of energy supply. Comparative and international political economy thus embraces an often highly significant 'subjective' element of sensitivity, which becomes particularly critical when low levels of subjective sensitivity discourage attention to potentially important areas of concern for anticipatory policy or when exaggerated levels of concern precipitate hasty decisions.

Notions of sensitivity thus relate closely to

those of international economic DEPENDENCE, INTERDEPENDENCE and INTERCONNECTEDNESS. Where sensitivities involve highly costly effects that may be experienced relatively rapidly but can be reduced or overcome only slowly and at further great cost, then international economic sensitivities signal serious levels of dependence. Where, in contrast, sensitivities concern low-cost effects that can be readily and rapidly reduced or overcome, then they may indicate little more than trivial economic connections. Economic sensitivity is thus an important concept within international political economy, but one that requires careful handling to discriminate between its 'objective' and 'subjective' facets, and to differentiate its more serious from its relatively trivial manifestations.

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R.J. BARRY JONES

serfdom

'Serfdom' refers to a set of relations under which one party is tied to another by inherited obligation. This pattern of relations became particularly prominent in Europe in the early Middle Ages and lasted in some forms until the middle of the nineteenth century (in Russia, for example).

During the Middle Ages, patterns of mutual obligations emerged between lords and those who were placed under their protection and jurisdiction. Among the many types of such obligations were serfdom and vassalage. While the latter was non-hereditary and consisted of the contractual obligations of free men, serfdom consisted of hereditary obligations from which serfs could not normally extricate

themselves. The term 'serf' derived from the Latin *servi*, meant to denote the unfree. It differed in some instances from slavery only in that the serf was under the protection of the lord.

Serfs were tied to the land and were obliged to farm it. Conversely, the holder of the land (the lord of the manor) was under obligation not to expel these unfree. The serfs, who held part of the area of the manorial territories from the lord, were bound to pay fixed rents – initially a share of their crops or livestock, and in the later Middle Ages sometimes money payments – and perform particular services (the *corvées*). They were also compelled to work the land held directly by the lord himself (the *demesne*) and could be required to perform work on roads or the castle, or to do whatever task the particular lord might assign. The serf's person, labour and the produce of that labour belonged to the lord. Servitude also meant subjection to special taxes and aids, as well as the obligation to use certain facilities provided by the lord, such as milling, for which payment to the lord was required.

Feudal lords were the ultimate source of jurisdiction within these territories. The lord passed judgement on disputes between tenants, decided on the transmission of holdings, even regulated marriage. Serfs were not legally permitted to hold any property other than movable goods of their own. The serf (man or woman) was 'homme de corps', the property of the lord.

Throughout the many centuries of its existence, serfdom took on a great many variations across Europe. Servile status could mean domestic serfdom, such as the 'villeins en gros' in England, who were at the lowest rungs of the ladder and whose status was barely distinguishable from ancient slavery. By contrast, others (particularly ecclesiastical and royal serfs) had more juridical rights. The holdings of the lords could likewise be distinguished in many types and variations across different geographic regions of Europe. Even within similar regions the particular types of obligations were subject to alterations over time.

In Western Europe, from roughly 1100

onward, serfdom started to decline. Emerging towns and lords competing for labour started to grant liberties to those who were unfree. The adage 'city air makes free' became common. In the East, however, from the late Middle Ages, the reverse happened: there, repressive serfdom deepened and was to last until the nineteenth century.

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HENDRIK SPRUYT

service economy

For most economists, both classical and neo-classical, the notion of the service economy simply refers to the important growth of the tertiary sector in the last decades. Services are essentially considered as 'dematerialized' or

services trade

'invisible products'. As such, they are supposed to fit into traditional economic analysis.

A fundamentally different analysis is based on the fact that services are functions and not products. They have become dominant in the last decades in all sectors of economic activity, particularly in industrial manufacturing. Service functions – from RESEARCH AND DEVELOPMENT (R&D) to quality control and from maintenance and distribution to waste management – are the key to creating economic value through performance of systems in time. This includes the notion of productivity, which equates with quality in reducing costs for better economic development over a period of time. Therefore, this view of the service economy leads to a fundamental reappraisal of the notion of uncertainty in economics, where prices cannot ideally correspond to a precise point of equilibrium. They do, however, refer to the ability to control and reduce uncertainties, where information cannot ever be entirely complete. The choice is between manageable and unmanageable uncertainty. Insurance activities provide a key to this problem by identifying and responding to the level of insurability of each and every economic activity.

It should also be clear that no product can function without services and no service can exist without tools of reference: every product is used for a function. The product is by definition material and the function is immaterial (a drug and the notion of healing, a car and the notion of transport). Therefore the service economy defines the moment at which, in the last decades, the costs to develop functions have surpassed the simple costs of producing hardware.

In philosophical terms, the service-based economic systems refer to indeterminism and DISEQUILIBRIUM theories (Popper, Prigogine) rather than DETERMINISM and equilibrium theories.

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ORIO GIARINI

services trade

For a long time services were characterized by the fact that their production and consumption could not be separated: that is, they were not storable. Therefore ADAM SMITH considered them as unproductive. At the end of the twentieth century, many nations have turned into service economies in which almost two-thirds of the employed people are working in the service sector (see SERVICE ECONOMIES). But to produce and supply services does not inevitably imply trade in services. This would only be the case if they could be stored and transported. Information technologies allow especially for the latter.

One can think of different kinds of services trade. First, foreigners may demand services and will therefore *import* them (for example, in tourism). Second, storable services could be delivered by different means of communication, such as through the post or the internet. Third, suppliers may travel abroad to export services (for example, consultants). Last, but not least, entrepreneurs could found commercial presences abroad. Because of these reasons, international trade statistics do not contain all relevant information on global services trade. Keeping this in mind, the relevance of services trade is obviously bigger than expressed in the data. Since World War II, services trade grew at a higher rate than aggregate world trade and global output. More and more international trade is undertaken in services. However, compared to their share in the national product, services are still underrepresented in international trade.

Why do nations trade in services? Generally the same reasons apply as for trade in goods: FACTOR ENDOWMENTS and/or natural resources, as well as economic policy and the extent of the relevant markets, equally result in COMPARATIVE ADVANTAGES in the production

of services. New means of communication made available by information technologies have reduced transaction costs, so entering foreign markets became easier for global players. Furthermore, extensive investment is a crucial necessity for introducing information technologies. Modern services are characterized by an increasing capital-labour ratio. Thus extending markets helps to reduce average unit-costs due to steadily increasing returns to scale.

Services trade shows a further consequence. The international division of labour is extended to all sectors. Traditionally, developing countries specialize in labour-intensive products of the manufacturing sector, but information technologies open up opportunities to supply worldwide human capital-intensive services – for instance, software engineering produced in India. Thus competition in these markets increased with the result that not only low-qualified but also high-qualified employees may lose their jobs and/or parts of their income due to GLOBALIZATION.

Furthermore, the volume of international services trade depends on the LIBERALIZATION of markets. Trade restrictions continue to limit growth possibilities in these markets. Therefore governments are making efforts to deregulate international trade, such as through the GENERAL AGREEMENT ON TRADE IN SERVICES (GATS) (1995).

See also:

trade theory; World Trade Organization (WTO)

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STEPHAN SEITER

severely indebted low-income countries (SILICs)

Many DEVELOPING COUNTRIES are still hampered in their development by the need to service heavy debts. These countries include some of the poorest – the severely indebted low-income countries (SILICs).

Although the DEBT CRISIS is over in the sense that there is now unlikely to be a collapse of the international banking system brought about by the default of major debtors, individual countries still have to cope with the debts they accumulated in the 1970s and 1980s. Many Latin American and Asian debtor countries have been successful in resuming growth after a period of stabilization and structural adjustment (see STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs)), and the debt problem now has a predominantly African dimension. Of the approximately thirty SILICs, two-thirds are in SUB-SAHARAN AFRICA (SSA). These countries have been particularly harmed by a combination of falling primary-commodity export earnings and high DEBT-SERVICE RATIOS. The consequent fall in import availability has reduced domestic capacity utilization and investment, and there have been growing arrears of debt.

Most of the debt of the SILICs is owed to governments and to international agencies: by 1993, commercial debt was only 15 per cent of the total.

See also:

highly indebted poor countries (HIPC) initiative; International Monetary Fund (IMF); Paris Club; soft loan; World Bank

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shadow industries

institutional details about measures to help the poorest debtor countries.

JOHN THOBURN

shadow industries

As the menace of Nazi Germany began to loom ever larger in the mid-1930s, the British government began to consider the measures that might be taken to ensure adequate capacity for future military production, short of embarking on an immediate, substantial and expensive campaign of rearmament. One attractive option was to enter into arrangements with leading industrial organizations within Great Britain for the joint financing of new industrial facilities that, while available for peacetime production, would also be suitable for rapid conversion to the wartime production of tanks, aircraft and a wide range of military equipment. One example of this 'shadow industries' programme was the new facility for aircraft production that the government started to negotiate in 1935 with William Morris of *Morris Cars* (one of the forerunners of *British Motors/Rover*) but which, initially at least, ran into difficulties over the proposed financial arrangement. However, pre-war preparations, like the creation of shadow factories, formed the background to the remarkable and unprecedented level of industrial mobilization undertaken by Britain once war broke out in 1939.

R.J. BARRY JONES

shadow prices

'Shadow prices' are 'estimated' or 'imputed' prices, used in economic analysis when (as inevitably sometimes happens) no actual market-determined prices can be observed, or when those prices that are available are grossly distorted or provide only a very partial reflection of overall costs.

For example, when deciding on the desir-

ability of a large public investment project (such as a new road or airport), the technique of cost-benefit analysis is often used. This involves compiling lists of the major effects (economic, social and environmental) of the investment and weighing the costs against the benefits. Monetary values generally provide the only means of comparing the magnitudes of the various disparate effects and hence arriving at an overall comparison of costs and benefits. The problem is that many of these effects cannot be directly priced, since they are not valued in a market. Shadow prices may then be employed as surrogates, using various indirect techniques.

A new road, for example, carries directly estimable construction costs; but there are other costs, perhaps including degradation of the local environment through noise and polluting emissions. Shadow prices for these might be estimated from expected effects on house prices in the area, as a surrogate measure of the loss of desirability of the area as a place to live. The benefits side might include estimates of the value of reduced travelling time.

Shadow prices are also used in more formal analyses involving 'optimization'. The entity to be optimized may (for example) be consumer utility, to be maximized subject to a budget constraint. Another example is the maximization of profit by the production and sales of goods which 'compete' for scarce resource inputs and can be produced in various possible combinations. In this latter case, a producer may wish to know how many units of each of two products should be produced. Each product requires a known input of capital and labour per unit of production. Returns on each good as a function of production level are known, as are the total capital and labour resources available. The optimization problem is then to find the profit-maximizing combination of the production levels of the two goods, subject to constraints on the total capital and labour available.

The analysis also provides information in the form of shadow prices for the capital and labour inputs, which show how total profits

would increase if one extra unit of capital and/or labour was available. These shadow prices can be compared with the actual prices of the inputs to assess the desirability of purchasing more of one or both of them and increasing production.

In the case of the maximization of consumer utility, the constraining input is the available budget, the shadow price of which is the increase in utility derivable from an extra unit of finance.

JOHN CLARK

shipbuilding

The world shipbuilding industry plays an important role in the international political economy. Although the industry is not a large producer of wealth in relative terms, shipbuilding is an important component of national trade and industrial policies. Because there is a strong overlap between merchant and military ship production, shipbuilding has historically been crucial to the development and maintenance of national military as well as economic power.

Developments in shipbuilding and navigation techniques were instrumental in shifting the locus of power and wealth from the Mediterranean to the Atlantic during the late Middle Ages. In the fifteenth century, these developments redirected Europe's expansionist impulses from overland routes converging on the Middle East to the maritime crossing of the Atlantic and, eventually, to circumnavigation of the globe. In the early sixteenth century, the Dutch consolidated power primarily through the use of merchant shipping, made possible by the possession of superior shipbuilding technology. Victory in a series of wars with the Dutch enabled Britain to acquire superior Dutch shipbuilding technologies, to end the freedom of the seas regime which reinforced Dutch maritime primacy and – by establishing and defending a mercantilist regime (see MERCANTILISM) – to eliminate the virtual Dutch MONOPOLY of seaborne trade.

Thereafter, Britain's commercial and industrial development would be underwritten by its growing mastery of SHIPPING and shipbuilding. In the nineteenth century, the development of steam and steel enabled Britain to sustain its paramount position by surmounting the challenge from advanced sailing ships (especially the US clipper ships) at a time when its own supplies of timber were depleted. By the middle of the nineteenth century, the abolition of the NAVIGATION ACTS and the re-establishment of an open shipping regime was made possible by Britain's virtual monopoly of shipping and superior shipbuilding. On the eve of World War I, British shipyards were responsible for three-quarters of world shipping tonnage. But the dramatic expansion of shipyards during World War I and the world depression of the 1930s (see GREAT DEPRESSION) provoked efforts to develop and protect national shipbuilding. By World War II, British shipyards had lost their lead in terms of tonnage and also technological capacity. The war precipitated a massive expansion of US shipyards. After the war, US merchant ships were distributed to Western European allies.

The post-World War II development of world shipbuilding was influenced by two key factors: (1) the tremendous expansion of world trade, which greatly increased the demand for ships, and (2) the fact that ship construction (with its links to steel) makes a large contribution to development, yet constitutes a relatively easy point of entry into the industrialization process. Together, these two factors account for the extraordinary volatility of shipbuilding, characterized by cycles of boom and bust, and the more or less permanent crisis of surplus capacity that has existed since the 1970s.

During the 1950s and 1960s, the shipbuilding industry enjoyed a global heyday. As world trade expanded, the demand for ships outpaced the supply. The global recession of the 1970s had devastating consequences for shipbuilding. Output plunged from 34 million gross registered tons (grt) in 1975 to 9 million grt in 1980. At various times during that decade, Japanese shipyards alone had a capacity in excess of

shipping

global demand. The crisis was particularly devastating for those shipbuilding nations that had failed to modernize or had relatively high labour costs. The labour force in the United Kingdom declined from 47,200 in 1976 to 4,500 in 1996 as British shipbuilding was denationalized and largely collapsed. In the same time period, employment in EUROPEAN UNION (EU) shipyards declined from 314,000 to 72,000 and in Japanese shipyards from 175,000 to 46,000. The United States stopped producing merchant ships for all but a limited number of government-protected routes.

The crisis of surplus capacity in the shipyards of advanced industrial countries was greatly exacerbated by the movement of developing nations into ship production. During the 1950s, Japan showed that COMPARATIVE ADVANTAGE in shipbuilding could be established through government policies and that the industry could greatly benefit more general economic development. Taking advantage of modernized production techniques, ECONOMIES OF SCALE and integration with new steel mills, Japan rapidly emerged as the global shipbuilding power; a similar – although more modest – trajectory was accomplished by South Korea, Brazil and (more recently) the People's Republic of China (PRC). By 1998, the PRC ranked as the world's third largest producer of ships after South Korea and Japan, and established a target of doubling its global share of business from 5 per cent to 10 per cent by the year 2000.

The shipbuilding crisis has given rise to a host of efforts since the 1970s to regulate the industry at the international level. The EU and the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) have sought to promote a variety of agreements designed to restrict government intervention and promote adjustment. For example, the OECD Council's Working Party on Shipbuilding has sought to develop agreement on market transparency and fair competition, and has sought to include DEVELOPING COUNTRIES such as the PRC, Brazil and India in its agreements. Yet overcapacity is likely to increase in the coming years as a result of further

improvements in productivity and the growing participation of developing countries.

See also:

transport costs

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ALAN CAFRUNY

shipping

As a basic infrastructure of international trade, shipping is a key source of wealth and power in world politics. The industry is an independent producer of wealth, an important lever of national trade and industrial policies, and a crucial element of military power. Historically, international maritime policies have been at the centre of MERCANTILISM, IMPERIALISM and WAR.

Since the time of HUGO GROTIUS, the Dutch lawyer for the East India Company and founder of modern international law (see LAW, INTERNATIONAL), the basic principles of

international order have found their expression in international shipping regimes. Thus Grotius' concept of *mare liberum* expressed the Dutch interest in international FREE TRADE during the first half of the seventeenth century, when the Netherlands possessed the largest and most technologically advanced merchant fleet. After defeating the Netherlands in a series of wars, Britain successfully broke the virtual Dutch MONOPOLY on seaborne trade by introducing a series of NAVIGATION ACTS, which formed the linchpin of the mercantilist system and served as the basis for British maritime development. As Great Britain moved to free trade in the middle of the nineteenth century, the government gradually repealed these laws, now establishing once again a free-trade system. This time British shipping virtually monopolized world trade routes until World War I.

At the present time, international shipping can be divided into two basic categories:

- 1 'Liner' shipping refers to that sector of shipping in which scheduled services are offered on fixed routes. Most manufactured goods, as well as perishable foods, are in this category, which comprises 20 per cent of world trade by weight but 80 per cent by value. British shipowners established liner conferences or CARTELS in this sector during the latter decades of the nineteenth century, defending their monopolistic practices with reference to greater efficiency and stability. During the twentieth century, as Western European countries (and, after World War II, Japan) developed significant fleets and concomitant shipbuilding capacity, their own firms gained entry into the conferences.
- 2 'Bulk' and 'tanker' shipping refer to that sector of international sea transportation in which raw materials and oil are carried. In contrast to the situation with liner shipping, bulk and tanker shipping is not organized into regularly scheduled services or conferences, although much of this type of shipping is horizontally integrated into the operations of raw materials MULTINATIONAL CORPORATIONS (MNCs). The traditional

maritime powers of Western Europe dominated this sector until the 1950s.

Since World War II, international shipping has been transformed by a combination of technological changes and the impact of US policies. The advent of steam and steel in the mid-nineteenth century led to a progressive decline of US merchant shipping and, as a result of relatively high labour costs, the United States suffered a comparative disadvantage in the international shipping sector. On the eve of World War II, the United States was not a maritime power, and practised extensive protectionism while also relying heavily on European shipping services. After World War II, however, the United States gradually sought to challenge the pre-eminence of Western Europe and Japan. In the bulk and tanker sector, the United States transformed the political and economic centre of gravity in the regime by sponsoring FLAGS OF CONVENIENCE (FOCs), which enabled independent owners and extractive MNCs to reduce labour costs and avoid taxation (as well as other forms of government regulation), thereby securing a substantial degree of control over not only the extraction and marketing of raw materials, but also over transportation. Although the system of flags of convenience was challenged by European shipowners, maritime unions and, later on, DEVELOPING COUNTRIES, it has remained a key factor in the bulk and tanker sector, and has served to limit the scope of national or international regulation in an industry which has historically been highly privatized.

After World War II, European and Japanese shipowners maintained their control over international liner shipping through the system of liner conferences which, by offering and enforcing 'loyalty contracts', served to prevent outsiders from competing with established carriers and to prohibit national merchant-fleet development. The introduction of the container ship in the 1960s, however, ultimately revolutionized both the economics and politics of this sector, paving the way for increased US participation in this sector as well. Prior to the 1960s, liner cargo was carried in small pallets in

short run

the hold of general cargo ships. Containers, or large steel boxes carried in the hold and on the decks of container ships, dramatically increased productivity (by a factor of ten) in this sector, making liner shipping highly capital intensive and thereby reducing the comparative disadvantage of high labour costs. The container ship spearheaded the entry of US firms into the liner sector. Their enhanced bargaining weight enabled them either to compete outside existing conferences as 'outsiders' or to gain admission into conferences on their own terms.

During the 1960s and 1970s, LESS-DEVELOPED COUNTRIES (LDCs) challenged the status quo in international shipping. Working primarily through the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) and its Committee on Shipping, they sought to establish a New International Maritime Order (NIMO) in which they would play a greater role in the transportation of their own trade. The principal mechanism of the NIMO was the UNCTAD Code of Conduct for Liner Conferences, a form of limited protectionism or 'cargo sharing', under which a fixed percentage of a country's national trade would be allocated to its own merchant fleet. However, cargo sharing was strongly opposed by the United States (which refused to sign the Code), as well as most European nations. Ultimately, it led to only very modest gains for THIRD WORLD shipping. In the bulk and tanker sector, similarly, LDCs were unsuccessful in their bid to phase out flags of convenience, which they perceived to be a means of distorting the COMPARATIVE ADVANTAGE that they possessed.

While international shipping has always displayed high levels of CAPITAL MOBILITY, the tendency towards internationalization of investment in shipping has become very pronounced in the last two decades. The modern shipping firm has access to a global capital and labour market. The logic of containerization and 'worldwide services' that link sea, rail and road transport has reinforced this trend and has tended to undermine liner conferences, which restrict innovation in services and technology. During the 1990s, a

number of international shipping mergers have taken place, while global alliances have been formed. As a result of chronic surplus capacity in shipping, even European shipowners have resorted to flags of convenience, leading governments to relax their own maritime regulations. As GLOBALIZATION has proceeded and alternatives to the marketplace have been rejected, inter-state conflicts have diminished.

See also:

International Maritime Organization (IMO); transport costs

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ALAN CAFRUNY

short run

In economic theory, the 'short run' is a time period used to describe adjustments to both demand and supply elasticity. The former describes the length of time it takes consumers to adjust their spending patterns when prices change; the latter describes the period of time in which a firm can make only partial

adjustment of its inputs to a change in conditions. In the short-run, a firm is said to only be able to increase output or supply by adding more of a variable factor (usually labour) and combining it with the fixed factor (usually land or capital).

The firm may have the flexibility to put its workers on overtime or vary their shift length almost immediately, but no major reconstruction can take place. For example, if American Airlines decides it needs twenty additional 747s, it will take a few years for Boeing to turn out the new planes that are required to accommodate the airline's demand. The short run for AA is therefore a few years in length, because it cannot change its fleet of planes in a shorter period. At the other extreme, a laundrette has a short run of a few weeks or months, since new machines can be installed and operational relatively quickly.

JASON P. ABBOTT

Simon, Herbert Alexander (1916–2001)

Herbert Simon was a US social scientist-at-large and the 1978 Nobel laureate for his 'pioneering research into the decision-making process within economic organizations' – especially for the study of corporate behaviour.

After spending a few years in research and administrative positions, Simon started his teaching career in 1942 at the Illinois Institute of Technology and received his Ph.D. in Political Science from the University of Chicago (1943). In 1949, he helped found Carnegie-Mellon University's new Graduate School of Industrial Administration, where he remained as professor, teaching subjects as diverse as economics, administration, psychology and computer science. In 1986, he was honoured with the National Medal of Science.

In a number of books and articles, Simon questioned the mainstream PARADIGM of RATIONAL CHOICE theory in economics. Exploring the limits of human RATIONALITY, he

coined now famous terms, such as 'bounded rationality' and 'satisficing'. Bounded rationality is a 'light' version of rationality – a mix of rules of thumb, traditions, experience and moderate expectations, continually adjusting due to environmental feedback. His behavioural economic approach to the theory of the firm (see BEHAVIOURAL ECONOMICS) emphasized the decision-making process of individuals and groups within the firm, whose limited knowledge (due to uncertainty and imperfect information) and limited ability to process information, guides them to the pursuit of satisfactory alternatives ('satisficing') instead of PROFIT MAXIMIZATION.

Another example of the application of his theory is his approach to employment as a relationship that is neither abstract nor the result of perfect contracting between agents with equal bargaining power, but a relationship whose crucial features are essentially responses to the cognitive limitations which lead to imperfect decision-making and thus imperfect contracting.

Simon was also one of the pioneers in operations research and artificial intelligence.

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Singer, Hans Wolfgang (1910–)

highly acclaimed study of the organizational structure of firms.

ARISTIDES N. HATZIS

Singer, Hans Wolfgang (1910–)

Educated at the universities of Bonn and Cambridge (where he studied respectively with SCHUMPETER and KEYNES), Hans Singer is one of the twentieth century's major figures in the field of development economics. After completing his doctorate at Cambridge in 1936, Singer worked as a researcher on the UK Pilgrim Trust Unemployment Enquiry, before taking up academic posts at the universities of Manchester (1938–44) and Glasgow (1946–7). Between 1947 and 1969, he held a wide range of posts within the UNITED NATIONS (UN) in New York, including Director of the Economic Division of the UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION (UNIDO), Director of the United Nations Research Institute for Social Development and Chief of the UN Development Section. In 1969, he returned to England as Professorial Fellow (later Professor Emeritus) at the Institute of Development Studies at the University of Sussex, a post which he still holds today.

Hans Singer has made many major contributions to the field of development economics and policy (including his analyses of the long-run behaviour of the TERMS OF TRADE between primary commodities and manufactured goods, and the distribution of gains between borrowing and investing countries), not only as a scholar of the highest order. However, he also served as an international civil servant, practitioner and policy adviser to governments and international agencies too numerous to list. Since joining the United Nations in 1947, the hallmark of Singer's work has been its focus on the problems faced by the LESS-DEVELOPED COUNTRIES (LDCs), not so much as a matter of abstract study, but with a view to devising and implementing measures to assist such countries. A prolific author and

policy adviser of legendary energy, Hans Singer was knighted (Knight Bachelor) in 1994 for services to economic issues.

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DAVID SAPSFORD

Single European Act (SEA)

The Single European Act (SEA), which entered into force in 1987, is probably the most underrated development in European INTEGRATION. Signed at an historical juncture when what is now the EUROPEAN UNION (EU) was seeking a means to make itself economically competitive in the face of successive recessions, it breathed new life into an integration process which had appeared to be petrified by ongoing differences between the member-states. The SEA was the means by which the member-states pledged to construct a common internal market by the end of 1992, thereby enabling them to withstand competition from Japan, the United States and later the booming economies of South-East Asia. It was also the first formal exercise in reform of the EU institutions. Thus

the SEA constituted the first part of the ongoing reform process with which the EU has been preoccupied ever since.

Although the precise balance of responsibility is difficult to attribute, it is clear that a number of key actors pushed for the SEA. The momentum of European integration had been building slowly throughout the 1980s – championed notably by the then President of the European Commission, Jacques Delors. He saw an opportunity to deepen the integration process by finally delivering the longstanding goal of a single EU market. His role as entrepreneur was shared by national leaders, especially Helmut Kohl (Germany) and François Mitterrand (France), eager to reap the benefits of ECONOMIC GROWTH and prepared to make concessions if necessary. Indeed, all member-governments supported the plan for the single market, although three of them (Denmark, Greece and the United Kingdom) had wanted to achieve it by means other than a formal intergovernmental conference. The business lobby was vociferously in support of the internal market. The difficult negotiations thus concerned how much political and institutional reform would be necessary.

Inevitably, the SEA outcome reflected bargaining between the member-governments, some of which wanted a commitment to a federal Europe and others of which sought to minimize the political impact. Nonetheless, to pass all the necessary legislation to build the internal market, the SEA reaffirmed the possibility of voting by qualified majority rather than unanimity in the COUNCIL OF MINISTERS, a move which theoretically ended national sovereignty in certain policy areas and ran counter to the history of European integration up to that point. It gave new powers to the European Parliament, although the latter remained a second-tier legislative institution. The EU acquired new competences in redistributive policy (cohesion policy), as well as other areas. Finally, the EU's fledgling foreign policy – European Political Cooperation – was given a treaty basis, albeit an intergovernmental one.

Compared with previous unsuccessful attempts to revive European integration (such as the European Parliament's 1984 Draft Treaty on European Union), the SEA appeared unambitious. It did not create a European federation and continued the dominance of economic integration over political integration. However, it was also more significant than usually understood at the time: partly since it set in train a series of further reforms, and partly because its measures proved to be less compatible with national sovereignty than was supposed by states such as the United Kingdom, which had considered that its more ambitious aspects would fail to be implemented.

See also:

Maastricht Treaty; Treaty of Rome

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ALEX WARLEIGH

skills

A skilled population is considered vital to national competition and survival in the information age. Technological advances require that states educate their populations to include increasing numbers of 'symbolic analysts'. According to Robert Reich (1991), symbolic analysts solve and identify problems by manipulating symbols in the form of numbers, words, and oral and visual representations.

small country assumption

These information producers and brokers are the key to competitive advantage in the global economy. A populace educated with these skills will be able to create and adapt to future technological innovations and remain at the fore of global competition.

James Rosenau (1990) argues that people throughout the world have become increasingly analytically and emotionally skilled. This 'skill revolution' is purportedly related to the major upheavals in social and political organization that accompanied the end of the COLD WAR. These dramatic events included the protests that toppled governments in Eastern Europe, the peaceful end to apartheid in South Africa and the suppression of the democracy movement in China. Rosenau argues that the skill revolution has enabled individuals and collectivities to question their leadership and effect change on political structures through demands, boycotts, rallies, protests, marches and electoral swings. Although collective action on this scale has previously occurred in history, it appears that the breadth and depth of citizen participation in global affairs is greater than ever before. This is because individuals increasingly have the capacity to link global events to their own personal circumstances, due to advances in education and technology.

Normatively, it appears that scholars in both economics and politics view increasing skill capacities as a positive development in the course of human affairs. Empirically, it may be difficult to assess the extent of the skill revolution and its relationship with political and economic change. Theoretically, an increase in analytical skills that furthers a state's economic competitive advantage internationally may also contribute to its domestic political instability or ungovernability. Such instability or sclerosis may negate the economic advantage gained by having a skilled population, as investors conducting political risk analysis place their funds elsewhere.

The skill revolution is closely linked to increasing levels of technology in the information age. The relationship between technology and skills is not as clear as simple technological determinism would suggest. Research in IN-

FORMATICS has demonstrated that while individuals may have access to advanced information technology, they often lack the ability to employ it properly due to systems designs that fail to account for institutional and cultural contexts that serve as barriers to effective usage. The result is that computerization has failed to produce massive increases in productivity. Thus, while skills may seem to be the saviour of states in the information age, their development and application is uncertain and may have unanticipated consequences for both domestic and international politics.

See also:

information society/economy

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CAMERON G. THIES

small country assumption

The 'small country assumption' is the assumption that a country is a price-taker on the world market. Such a country faces perfectly elastic demand for its exports and perfectly elastic supply for its imports. Therefore, a change in the level of its imports or exports will have no effect on the world market price.

Trade policy prescriptions derived under the small country assumption may produce perverse results in situations where the assumption is not valid. For instance, if a country is a major supplier of a certain commodity to the world market, then an increase in its exports would significantly increase world supplies and

lower the price, resulting in a less than proportional increase or possibly even a loss in export earnings. This situation is most likely to occur in primary commodity markets. Similarly, if a number of small countries simultaneously increase their exports of a commodity, the combined increase in world supply may be large enough to influence the price: this is known as the FALLACY OF COMPOSITION. Finally, VOLUNTARY EXPORT RESTRAINTS (VERs), such as those in the MULTI-FIBRE ARRANGEMENT (MFA), can make demand for a country's exports less elastic and grant some MARKET POWER to even a small country.

JOHN M. TALBOT

Smith, Adam (1723–90)

Adam Smith is the pre-eminent philosopher of liberal political economy (see LIBERALISM). He is noteworthy for both the range and depth of his thought on the relations between politics and economics and between morals and self-interest. None of these were separate topics for Smith. Instead, he conceived of the study of political economy as part of one social philosophy, albeit one with important internal tensions. In the course of his intellectual career, he also illuminated important policy questions in both domestic and INTERNATIONAL POLITICAL ECONOMY (IPE). Domestically, he explored the psychology of moral behaviour, the sources of ECONOMIC GROWTH and DEVELOPMENT, and the role of both the INVISIBLE HAND in markets and the minimal state in a LAISSEZ-FAIRE society. Internationally, he outlined a critique of TARIFFS and COLONIALISM. He also explained the logic of commercial pacifism – the doctrine holding that market societies are fundamentally against war. He connected domestic and international political economy by explaining how the societies of war-prone Europe had evolved, were evolving and could continue to evolve through stages of social progress toward an international system

in which the incentives for war were muted by rational ties of mutually profitable commerce.

Smith's life

Adam Smith was born in Kirkcaldy, Scotland, son of Adam Smith (the local comptroller of the customs) and Margaret Douglas (daughter of a substantial landlord). Educated at the University of Glasgow, from which he graduated in 1740, he was inspired by the teaching and example of Francis Hutcheson, the moral philosopher who was one of the leaders of the Scottish enlightenment. Smith later attended Oxford for six years of largely independent study. Returning to Glasgow, he was invited to give a series of public lectures whose quality led to his appointment as professor of logic (1751) and then of moral philosophy (1752). He published his first major work, *The Theory of Moral Sentiments*, in 1759. This important contribution to moral psychology earned him wide renown and in 1763 the offer of becoming the tutor (with a life pension at a salary much above that of his professorship) of the young Duke of Buccleuch, who was about to begin a tour of the Continent. Smith's two years of travels brought him into contact with the leading intellectuals of Europe, including Voltaire, J.J. Rousseau, David Hume and the French political economists – pre-eminent among them being François Quesnay, who greatly influenced Smith. The French economists persuaded him that wealth should be conceived of not as money but as the physical productive capacity of land. Returning to England and alternating between London and Kirkcaldy, Smith broadened these ideas in what he planned to be a sequel to *Moral Sentiments*, which he published in 1776 as *An Inquiry into the Nature and Causes of the Wealth of Nations*. Two years later, he accepted the appointment of commissioner of customs and salt duties for Scotland (an odd but lucrative choice for an advocate of FREE TRADE) and divided his time between Edinburgh, Glasgow (where he served as rector of the university) and London. He repeatedly revised his two great works and died in 1790 at the age of 67.

Liberal domestic political economy

The pursuit of wealth, according to Adam Smith, not only satisfies human interests but could, if well organized, contribute to moral perfection. A system of 'natural liberty' in which the state respects basic freedoms allows individuals free rein (*laissez-faire*) to develop cooperative productive enterprises and satisfy their wants as consumers. Market exchange can produce a 'natural progress of things toward improvement', because it encourages the efficient production of a DIVISION OF LABOUR (Smith, 1976 [1776]: vol. 1, p. 443). In Smith's famous pin factory, ten workers – each specializing in one of various tasks – turn out 48,000 pins a day, thousands of times more than the one or two pins that each worker could have produced on their own by engaging in all the tasks required to produce a pin. The larger the market, the more such factories will be profitable. Markets, moreover, are self-regulating. Owners of factories will and can invest in machines and pay workers more. Labourers in turn have a natural incentive to have larger families and a larger labour supply will constrain the rise in real wages. The market thus induces individuals to consume and produce in ways that rationally adjust their activities to the intensity of their effective demands for goods versus money, work versus leisure, security versus risk and present versus future consumption. Free-market exchange thus can ensure that the consumer is 'led by an invisible hand to promote an end which was no part of his intention' (*ibid.*: vol. 1, p. 456). Individuals exchanging in a market generate a 'public interest' that encompasses increasing national wealth and a non-coercive society when they exercise the freedom to choose and cooperate by making rational choices.

Smith is thus arguing not just for the economic superiority of the invisible hand and *laissez-faire*. He is also a liberal political and moral economist: commerce can not only lead to individual material and psychic 'happiness', but can also contribute to 'perfection' by allowing the exercise of moral liberty – the freedom to choose – in a CIVIL SOCIETY. A

society that permits 'natural liberty' allows individuals to shape their own lives free from the need to submit to coercion. According to Smith, the alternative to a free society is STATISM which, even if well-intentioned (*pater-nalistic*), is usually ill informed, inefficient, corrupt, potentially violent and morally degrading coercion.

Free individuals moreover could lead moral lives without external coercion. *The Theory of Moral Sentiments* demonstrated how self-interested human beings could be motivated to pay heed to the virtues of benevolence and justice by means of an instinct for sympathy. Sympathy was guided by social approval and disapproval. Where we would have reason to doubt that our motives could be fully known, we have a capacity to imagine ourselves in another's place and to perceive our own actions from the viewpoint of an 'impartial spectator'. The 'invisible hand' thus regulates the self-interest of free individuals in their material interaction to produce a public interest, just as the 'impartial spectator' regulates the contest between passion and duty. Together, they make a self-regulating society possible.

The state, however, does have a legitimate role. Smith differs in this from modern ideologies of liberal economics that hold that economics should determine politics. Indeed, no one is to be trusted less than a merchant or landlord legislating in their own interest. Smith developed an authentic liberal political economy, one founded on the progressive realization of a public interest in civic freedom that shapes both what the market should be allowed to do and what it should be prohibited from doing. The state, he argues, should do what the market cannot do well (in terms of public interests) and leave to the market what the market can do better (in terms of public interests). States have three, but only three, duties: (1) defence, 'protecting the society from the violence and invasion of other independent societies ... which can only be performed by means of a military force'; (2) the administration of justice, 'protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it ... ',

and (3) 'erecting and maintaining those public institutions and those public works, which ... though most advantageous ... are such that the profit could never repay the expense to any individual or small group of individuals' (ibid: vol. 5, book V, ch. 1 *passim*). By this last, Smith means what we would now call PUBLIC GOODS, such as roads, bridges and canals. Overseas commerce may need the security of forts and the assistance of an ambassadorial service. Religious instruction according to choice is of value to the society as a whole. And the youth, especially of the poor, will need state assistance to become properly educated in writing, reading, arithmetic and the martial arts that are suited to the forming of an effective military force. Defence and the maintenance of the chief magistrate are charges that are best levied on the public as a whole through direct taxation; other PUBLIC GOODS may call for general taxation, but only if local revenues or charges on the direct beneficiaries are not sufficient to meet their expenses. A bridge may be a public work, but it should be paid for, where feasible, by a local toll on users.

One role that the state does not play is to provide for an egalitarian or progressive redistribution of property or income. Freedom counts more than equality for Smith. Justice thus consists of protecting property, not redistributing it according to some principle separate from prior ownership. Market societies will increase the demand for labour and are conducive to great increases in efficient social product through the division of labour, benefiting all consumers and increasing employment. The poor in manufacturing Europe, Smith opined, actually were better off than kings in Africa. But this should not be romanticized. Markets could not be relied on to offer anything but a long-run subsistence wage to the poor, matching the supply of labour to its wage price. Even in a 'civilized society', therefore, population is regulated by 'destroying a great part of the children which their fruitful marriages produce' (Smith, 1976 [1776]: vol. 1, p. 39).

Liberal international political economy

Two of the hoariest myths of IPE are that the realist mercantilists were interested only in power and the liberals were interested only in wealth (see MERCANTILISM; REALISM). The mercantilists were said to focus only on maximizing a positive BALANCE OF PAYMENTS (storing up gold the better to be secure) and the liberal free traders, such as Smith, were said to have no appreciation of INTERNATIONAL SECURITY and to be prepared to trust all to free markets. Smith, in his famous and devastating critique of the mercantilists, seems to have contributed to the first stereotype.

In a penetrating essay, JACOB VINER effectively frees the mercantilists from the charge of power mania. Viner notes that the clearest formulation of what was to become the stereotypical mercantilist view was that of Louis XIV's finance minister, Jean-Baptiste Colbert, who said: 'Trade is the source of finance and finance is the vital nerve of war' (Viner, 1948: 7). Colbert's statement has been used to illustrate the supposed mercantilist thesis that the purpose of trade is to generate a positive balance of payments and tariff revenue, hence an inflow of gold, which then may be used to finance wars, especially wars overseas. But the real object of mercantilist policy, Viner has shown, was both power and wealth, and was better represented in a comment by the eighteenth-century British statesman Lord Bolingbroke:

By trade and commerce we grow rich and powerful and by their decay we are growing poor and impotent. As trade and commerce enrich, so they fortify, our country.

(ibid.: 16)

It is equally wrong to see Smithian liberals as neglectful of power or forgetful of the connection between security and wealth. Defence is the first duty of the sovereign and as such prior to 'opulence'. Smith's critique of the mercantilists was based on their policies, not their ends of power and wealth. The real differences, then, between the realists and

liberal political economists lie in their differing conceptions of the worlds in which states pursue their interests. Specifically, Smith rejects two of the favourite policies of the mercantilists: colonies and tariffs. In doing so, he argues that in rejecting colonialism and adopting free trade, rational liberal political economists would thereby eliminate two potent causes of aggressive war. But Smith's larger contribution lies in outlining an evolutionary model of the political economy of international security that explains the changing economics of attack and defence, and identifies a political economy conducive to peace.

Anti-mercantilism: tariffs and colonialism

Smith denounces mercantilism as advocating BEGGAR-THY-NEIGHBOUR POLICIES, a view he sees as being foisted on a weak public equally by the 'violence' of rulers and the 'monopolizing spirit' of merchants and manufacturers. Mercantilism considers another's gain as one's own loss. It makes 'commerce, which ought naturally to be among nations, as among individuals, a bond of union and friendship ... the most fertile source of discord and animosity' (Smith, 1976 [1776]: vol. 1, p. 493). This was the famous problem of relative gains versus absolute gains from trade.

Adam Smith addresses the relative gains problem in political economy in its three classic aspects. Relative gains govern either (1) because any external interference with domestic law and order is destabilizing (so the less interference the better), or (2) because trade can be manipulated advantageously and produces, in any case, very little mutual gain, or (3) because the insecurity of world politics means that only the relative gains are valued, since only they produce security *vis-à-vis* rivals.

Smith rejects the first view, associated with such realist nationalists as Rousseau, because he sees international exchange as expanding the range of autonomous individual choice, which should be a fundamental purpose of social institutions and was indeed the key moral justification he proposed for market society.

The second aspect, the economic problem, of relative gains involves the value of colonies and tariffs as sources of wealth. Colonies and tariffs are two aspects of the same problem for Smith. Both tend to privilege certain groups of producers and merchants over and above the true interests of consumers and the nation as a whole. Neither is inherently bad. Colonies expand the market and allow for a greater division of labour and hence greater efficiency and more product. Tariffs and other trade restrictions might be necessary for national security (to build a navy, for example) or for temporarily subsidizing foreign trade in a new and risky area. But, generally, colonies and the trade restrictions associated with them are harmful. They stir up conflict with other countries. They cost the taxpayer money for colonial military campaigns and in tariff administration. And they distort economic activity away from efficient allocations to subsidized ones, reducing overall welfare by forcing consumers to buy dear (at home, one's own colonial imports; in the colonies, metropolitan exports). This, in turn, reduces overall product by encouraging investors to allocate capital to artificially profitable (subsidized) production in place of the most productive investment.

That free trade – unsubsidized and unrestricted – maximizes global welfare and that no other policy is likely to be better for a country are views shared by most modern economists. Although an ideal decision-maker possessed of PERFECT INFORMATION in a world where no rival could retaliate might be able to allocate subsidies (or tariffs) optimally to take advantage of dynamic, high-wage industries with increasing returns to scale, the usual decision-maker (who is faced with foreign rivals who are likely to retaliate) will find 'strategic optimizing' to be unpromising. Japan and Sweden appear to have successfully pursued an optimum industrial policy in the early post-World War II period, but they succeeded in part because the industrial leader (the United States) was for strategic reasons not prepared to retaliate and in part because they were investing in known catch-up technology. Simi-

lar industrial strategies today are more perplexing, facing an unknown technological horizon, no leader and probable retaliation.

According to Smith, trade benefits an economy in three ways: (1) it offers an opportunity to exploit ABSOLUTE ADVANTAGES, trading goods that a country produces efficiently for those that it does not; (2) it offers a vent for surpluses otherwise wasted or producing a glut on the market; (3) it allows for a widening of the market, which encourages an increased division of labour and greater productivity. These advantages are shared (even though not equally) which produces a harmonious material interest in a regime of free trade (more rather than less trade) and for international cooperation (to avoid foreign policies that would disrupt trade).

Free trade, however, does not solve the third problem of IPE. Trade should generate mutual gains, but these gains need not be equal. For the pure (non-envious) economist this is not a problem, but for a political economist it can be. What if the differential gains reduce security by, for example, advantaging a strategic rival? What if all states are in a mutual state of war, balancing capacity against capacity, as the realist argues they must be? 'In a world of competing states', the US political economist ROBERT GILPIN has noted, 'the nationalist considers relative gain to be more important than mutual gain' (1987: 33).

Pacific evolution

The essential problem was determining when security was (and when it was not) a problem for IPE. In a famous passage from *The Theory of Moral Sentiments*, Smith sounds very much like THOMAS HOBBS and other classic realists: 'Independent and neighbouring nations, having no common superior to decide their disputes, all live in continual dread and suspicion of one another'. But rather than structural necessity, Smith emphasizes passion and contingency, immediately preceding the quoted sentence by noting that 'love of our nation often disposes ... with the most malignant jealousy and envy ...', viewing the prosperity of any other

neighbouring nation with suspicion (1969 [1759]: vol. 6, p. 373). In the later *Wealth of Nations*, Smith elaborates:

The wealth of a neighbouring nation, however, though dangerous in war and politicks, is certainly advantageous in trade. In a state of hostility, it may enable our enemies to maintain fleets and armies superior to our own; but in a state of peace and commerce it must likewise enable them to exchange with us to a greater value, and to afford a better market, either for immediate produce of our own industry, or for whatever is purchased with that produce.

(1976 [1776]: vol. 1. p. 495)

Wealthy France, by that account, should have been Britain's best market and vice-versa. Instead, of course, France in 1776 was Britain's greatest rival and each raised great barriers to free trade against the other, which were justified by 'national animosity' exacerbated by their closeness as neighbours and by the 'mercantile jealousy' stirred by the 'passionate confidence of interested falsehood' that rival merchants and manufacturers had foisted on the two publics. Their 'real interests' lay in peace and free trade; their actual policies were bellicose and restrictive.

Liberal international political economists agree with realist political economists on the importance of a political foundation for the international economy. Lacking such a foundation, economics becomes 'politicized'. Trade is dangerous and economic dependence makes states insecure. Depoliticization, on the other hand, requires a political foundation. The realists thus posited the need for HEGEMONY – a dominating power that imposes INTERDEPENDENCE and overcomes the tendency of equal states to prefer AUTARKY to DEPENDENCE. Liberals too sought a response to security-motivated searches for autarky, as hostilities resulting from insecurity would disrupt trade.

Could these insecurities and hostilities be curbed? Possibly. Smith was far from confident, but he did outline in Book V of the *Wealth of Nations* as a possible pacifier an evolutionary

sociology of changing international systems: Some societies are aggression-dominant and others peace-dominant, and history can evolve (albeit unevenly) from the first to the second. 'Commerce and manufactures', he argued, 'gradually introduced order and good government, and with them, the liberty and security of individuals, among the inhabitants of the country, who had before lived in a continual state of war with their neighbours, and of servile dependency upon their superiors. This though the least observed,' Smith added, 'is by far the most important of all their effects' (ibid.: 412).

WAR, Smith seemed to believe, is a rational function of two factors: the spoils that successful aggression gains and the cost of war. The latter, in turn, is determined by the opportunity cost of war and the net costs of war (a function of the chance of winning, the direct costs of conquest and so on). The larger the spoils, the lower the direct and opportunity costs, the more likely the war, and vice-versa for peace.

The calculation changes according to the condition of society. Among a nation of 'hunters, the lowest and rudest state of society' – the society one finds in Smith's time among 'the native tribes of North America' – every man is a warrior as well as a hunter. Hunting is a full-time occupation and war takes away from hunting. The spoils offered by other hunting societies are slight, very much what the hunter already has or could obtain by further hunting. Other hunting tribes are likely to be as skilled at war as one another and none of them generates large numbers of inhabitants or stable hierarchical leadership. Aggression therefore makes little sense.

'Among nations of shepherds', such as the ancient Israelites, the Arabs and the Tatars, on the other hand, aggression is much more attractive. War for them, united behind chiefs, is an efficient employment of their abundant leisure. Their flocks and families follow them in campaigns of conquest, some of which are driven by the need to discover fresh pasture and others by the search for the flocks and women that other pastoral nations afford. An outdoor life keeps them physically fit for battle

and pastoral economics allows great concentrations of forces, making them, unlike hunters, difficult to deter.

Among nations of 'husbandmen' – farmers – such as the Ancient Greeks and Romans, military readiness comes easily. The life is healthy and the technology simple, ditch-digging and fortification being close cousins. But for them the costs of war are significant. Time at war is time away from their fields and fixed homes. But if campaigns are fought after the seed has been sown and before the crop needs to be harvested, the opportunity costs of war are not too exorbitant. Then a fifth or more of the population can be spared for war.

But among a nation of 'manufacturers' there is no leisure time. All is work and every soldier is a labourer taken away from manufacturing. Manufacturing, moreover, makes labourers unsuitable for the trade of soldier. Militias tend to be very unreliable, with a militia of industrial labourers being much less capable than a militia of farmers. Sovereigns thus form professional standing armies, which must be paid in times of peace as well as war. War being so very costly, there then follows a natural incentive both to maintain peace and to neglect defence (ibid.: vol. 1, book V, ch. 1 *passim*).

The neglect, however, is a serious but unnecessary danger of modern societies, Smith warns. Since the spoils of conquest rise with the state of civilization, manufacturing societies are natural prey for militaristic pastoralists and farmers. Modern societies must find a way to raise the net costs of aggression by reducing the chance of success. Standing professional armies fortunately do just that. Their superiority over militias is based on their ability to afford expensive weapons (firearms) and on the superior training that allows them to employ those more sophisticated weapons. Fortunately as well, Smith notes that the danger standing armies pose to civil liberty is much less than has often been assumed. The Roman professional armies destroyed their republic because they were a separate caste of soldiers. If the army is entrusted to the ruling classes, as it was in the Britain of Smith's day, it will protect the state and serve to educate unruly peoples. Even

more, it will allow for civil liberty, because popular disturbances will be little threat to such a force. The Smithian ideal thus appears to be a professional force, which will be cheap and non-aggressive (because it is small) and effective (because it is professional).

We can infer that aggressive war is irrational for both hunting and industrial societies. Presumably, therefore, a world composed solely of hunting societies or industrial societies would tend to be at peace (if states were rational). In relations between hunters and industrialists, and in relations within pastoral or agricultural societies, war would be a constant danger.

Modern anthropological studies lend some substance to Smith's views. Smith's commercially pacific manufacturing does seem to make a difference. But there is little ground for complacency. The two most destructive wars, World War I and World War II, were fought between industrial societies. For too many modern societies, industrialization magnified the capacity to inflict pain, rather than removing the incentive to fight.

Adam Smith's message for the international political economists of the dawning age of manufacture was thus at best one of cautious hope. Perhaps, he suggested, relations between industrial societies would be peaceful if they realized how uneconomic aggressive war could become. He realized that France and Britain in 1776 were each other's greatest enemy, but this may have been either because both were in transition from agricultural to manufacturing societies, or because both were very susceptible to irrational passions. The progress of society in both dimensions, social and moral, was the key. Adam Smith set out to discover the social foundations of morally rational individual behaviour. Commerce and armies together could, he argued, push societies from servile dependency and a continual state of international war to something better, a civil society enjoying natural freedom and the prospect of peace.

See also:

Marx, Karl Heinrich; Mill, J(ohn) S(tuart)

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Smoot–Hawley Tariff

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MICHAEL W. DOYLE

SMITHSONIAN AGREEMENT *see* gold exchange standard

Smoot–Hawley Tariff

Originally proposed by President Hoover to help farmers, the 1930 Smoot–Hawley Tariff Act imposed a general **TARIFF** increase that resulted in the highest nominal tariffs in US history. European nations reciprocated by also increasing tariffs, contributing to the decline in the volume of world trade due to the **GREAT DEPRESSION**.

See also:

beggar-thy-neighbour policy

MARC D. HAYFORD

social democracy

Ideologically, 'social democracy' has changed dramatically since it first emerged over a century ago. Although for most of its history it was synonymous with demands for state ownership and control of the fundamental means of production and distribution of

wealth, social democracy nevertheless represents a curious mixture of liberal and socialist traditions that are a product both of its history and development. However, if one thing in particular can define 'social democracy', then it must be that the reconstruction of the existing capitalist or other political system of a country was to be achieved through peaceful, democratic and parliamentary means, rather than through revolution. In addition, particularly since World War II, distinctions have sometimes been made between social democrats and socialists on the basis that the former have accepted the permanence of the mixed economy and have abandoned the idea of replacing the capitalist system with a qualitatively different socialist society (see **SOCIAL DEMOCRATIC PARTIES**; **SOCIALISM**).

The emergence of social democracy corresponds with the emergence of an industrialized working class in Europe (see **CLASS, WORKING**), particularly in the industrial heartlands of Western and northern Europe. The emergence of politically organized labour on a mass-scale allowed socialist ideas, hitherto the domain of middle-class intellectuals (such as the Fabian Society in Britain), to acquire both reality and historical force, and in the process to create a new genus of political party. Foremost among such ideals was Marxism which, in effect, emerged as the official ideology of socialist parties (see **MARXISM–LENINISM**). Whereas, prior to the rise of social democracy, political parties had been little more than cliques of prominent individuals, working-class political parties were by contrast hierarchical disciplined structures founded on a mass membership.

However, perhaps the strongest and most consistent feature of social democracy has been its allegiance to parliamentary democracy. Towards the end of the nineteenth century, despite the worsening condition of the proletariat, **CLASS STRUGGLE** and revolution had not come about. As a result, many socialist thinkers began to doubt the indispensability of revolution, instead arguing that socialism could best be attained by reformist and evolutionary methods. On the assumptions that wage earners would eventually form the

majority of the population in most European countries and that universal franchise would be won, social democrats increasingly viewed parliament as the main focus of their efforts. However, abandoning revolution for parliamentary struggle bitterly split the left across Europe, and nowhere was this split more bitter than in the largest socialist party in Europe: the German SPD.

From the 1890s, Eduard Bernstein argued that the SPD should abandon its commitment to revolution and adopt a form of evolutionary socialism. By concentrating on the parliamentary process, Bernstein argued the SPD could attain a majority in the German parliament and then attempt to alleviate Germany's social iniquities by legislation. Bernstein's policy was, however, defeated within the party both in 1899 and again in 1903. Such divisions were also a source of division within international socialism. For example, the Second International of 1889 was split between the revisionists led by Bernstein, a radical wing that included ROSA LUXEMBURG and LENIN, and a third Marxist group led by KARL KAUTSKY against Lenin. Indeed, the Second International only avoided complete failure by adopting a broad set of doctrinal principles that left aside the manner in which they would be achieved. Nonetheless, when World War I broke out across Europe, all the principal social democratic parties abandoned their socialist solidarity to support their respective governments' war efforts. As a result, the Second International collapsed.

Far from rallying social democracy, the victory of the BOLSHEVIK Party under Lenin in the 1917 Russian Revolution was to divide the European left most bitterly of all. By the time of the Third International in 1919, a number of European socialists had become concerned at the growing dictatorial features of the Soviet state. At the International, under Soviet direction, all parties that did not subscribe to certain conditions were branded revisionist and excluded from membership of the Socialist International. These conditions included a commitment to agitation and revolution, the disapproval of reformism and a commitment to abstain from participation in

any kind of bourgeois democratic institution. These conditions, and the creation of rival sanctioned communist parties under the direction of the Comintern in Moscow, created an immutable barrier between COMMUNISM and social democracy, and indeed this was the purpose behind the International's actions.

As a result of the schism on the left, social democrats found themselves ideologically adrift. Having rejected revolution on ideological grounds and having been shunned by communist movements, many social democratic parties began to turn to liberal democracy. Although social democrats were antagonistic towards capitalism, they now had no clear-cut alternative to it. Ironically, it was at this time that social democrats found themselves entering government for the first time across Europe. In Germany, for example, the SPD provided the first president and chancellor of the Weimar Republic and indeed it was they who suppressed the communist rising in Berlin in January 1919 in which Luxemburg died.

From the 1930s onwards, the influence of Marxism on social democracy increasingly declined. Indeed, during the inter-war years social democrat governments across Western Europe slavishly pursued orthodoxy in economic and financial policy. Nonetheless, it was during the inter-war years that the beginnings of social democracy's commitment to the WELFARE STATE emerged. Although the work of English economist JOHN MAYNARD KEYNES provided the theoretical foundations for the welfare state, inter-war Sweden provided the actual demonstration that such policies could work in practice.

One of the earliest proponents of Keynesianism was Ernst Wisgorf, the principal theoretician of the Swedish Socialist Workers Party (SAP). Wisgorf and other economists such as GUNNAR MYRDAL, Bertil Ohlin and Dag Hammarskjöld broke with conservatism in economic policy to conclude that deficit spending could be used as a means of stimulating economic activity. What these economists proposed was a programme of public expenditure and employment funded

by government borrowing. The success of the programme enabled the SAP, with its partner the Agrarian Party, to lay the foundations not just of the welfare state but also of the political dominance of post-war Swedish politics by social democrats. While President Roosevelt's New Deal in the United States shared many similarities with the strategy of Wisgorf, the Swedes not only demonstrated that the new economics of Keynesianism worked, but were the first to marry Keynesianism to social democratic objectives – thus, in the post-war world, social democracy became synonymous with full employment and the welfare state.

Unlike World War I, World War II gave social democrats a new purpose. This time, war did not bring with it a conflict of interests between patriotism and socialism like the one that had split communists and socialists in 1914. On the contrary, communists, socialists, liberals, nationalists and conservatives united to fight FASCISM, most visibly in the various Continental resistance movements. In Britain, the Labour Party returned from the political wilderness to take up posts in Churchill's wartime cabinet and, as peace drew near, most political parties on the left made plans to become mass popular parties in the post-war era.

The experiences of the war, coupled with post-war economic prosperity and the onset of the COLD WAR, served to moderate social democracy in Western Europe. In particular, most social democratic political parties either abandoned or toned down their commitment to the socialization of the means of production. In Keynesianism and the welfare state, social democracy appeared to have found an alternative to capitalism and the STATE SOCIALISM of the communist bloc. This ideological change was most clearly exemplified in the Bad Godesberg Principles adopted by the German SPD in 1959, which in calling for 'as much market as possible ... as much planning as necessary' even recognized that private capital had a role to play in a mixed ownership economy. While the peak of support for social democracy came in the 1960s and 1970s, only in Sweden and Austria did social democratic parties ever

achieve an overall majority of the popular vote (50.1 per cent and 51 per cent respectively).

Despite the adoption of more moderate political goals by most European social democrats, the 1970s saw a number of social democratic parties pursue a more radical agenda at a time when the world economy experienced its most prolonged cyclical crisis since the end of World War II. In Britain and Sweden particularly, social democratic governments attempted to proceed with the socialization of the means of production. In the former, this was to be achieved by greater state control over industry and the economy, while in the latter through the creation of wage-earner funds which would gradually transfer ownership of private firms into public hands. Such trends reflected the fact that, despite their successes, social democrats remained ideologically divided over what was the ultimate goal of social democracy. The revisionist position, represented in the Bad Godesberg Principles and the work of Anthony Crossland (1966 [1956]), believed that the attainment of social welfare systems and a mixed economy negated the need to aim for a socialist state to alleviate inequality; the radicals, in contrast, believed that such achievements were merely triumphs on the path to a democratic socialist state.

Such radical policies, coinciding with rising unemployment and INFLATION (OR STAGFLATION), union militancy and poor economic growth, contributed to a marked decline in the political fortunes of social democracy in the West. Beginning in Britain in 1979 with the election of the Conservative Party under Margaret Thatcher, social democratic governments were slowly replaced by conservative ones elected to 'roll-back' the welfare state. Ideologically, the Keynesian fundamentals at the heart of welfarism were challenged by the emergence of neo-classical economic theory under the rubric of monetarism (see MONETARISM; NEO-CLASSICAL ECONOMICS). In 1983, the German social democrats were defeated; in 1991, the hegemony of the Swedish SAP was finally brought to an end by the victory of the centre-right coalition under Carl Bildt. By the time of the defeat of the French Socialist Party

in 1993, Spain was the only large country with a social democratic government, but even they (like their socialist neighbours in France) had in practice accepted the economic orthodoxy of the New Right.

With this decline in support came a renewed period of ideological uncertainty. The electoral triumphs of conservatism combined with the collapse of communism in Eastern Europe and the Soviet Union left social democracy adrift once again, particularly since the 'end of socialism' apparently rendered the attainment of a socialist state superfluous. Furthermore, class dealignment and the decline of manufacturing industries undermined the foundations of traditional support for social democracy. An ideology born of the INDUSTRIAL REVOLUTION found itself trying to recast its appeal in an era marked by revolutions in communication and information technology. Consequently, social democracy found itself vying for the political centre and the votes of the middle classes. Borrowing heavily from the electoral triumph of the Democrats in the United States in the 1992 presidential election, the British Labour Party under Tony Blair has championed a so-called 'Third Way' between socialism and free-market capitalism. Shedding much of its previous commitment to public ownership and socialism, critics have argued that the 'New' Labour Party is barely distinguishable in policy from its opponents on the centre-right. Nonetheless, while ideologically the 'Third Way' may be regarded as marking the rejection of the original goals of social democracy, electorally it appears to be paying dividends. Since the victory of the British Labour Party in 1997, social democrats have returned to power in every large European country except Spain. More than a century after social democracy became a major political ideology, the cause of improving contemporary economic and social life, particularly for the more disadvantaged groups in society, continues to be a relevant force.

See also:

Keynesian economics; Marx, Karl Heinrich; social democratic parties

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JASON P. ABBOTT

social democratic parties

At the end of the nineteenth century, mass working class political parties (see CLASS, WORKING) rapidly appeared on the scene as a result of the INDUSTRIAL REVOLUTION. Beginning with the creation of the German Social Democratic Party (SPD) in 1869, socialist and labour parties quickly emerged as major forces across Europe and beyond. The creation of the German SPD was closely followed by the creation of the Danish SDP and the Norwegian Labour Party in the 1870s, the Belgian Labour Party, Swedish Socialist Workers Party (SAP) and Austrian SDP in the 1880s, and the Dutch Socialist Workers Party in 1894. In Britain, although the modern Labour Party was not founded until 1906, it emerged from several

social democratic parties

earlier movements. Labour parties also sprung up outside Europe, including ones in Argentina, Australia and even the United States. However, although political parties adhering to social democratic principles exist worldwide, the most successful have been found in Western Europe.

From its beginnings, the sharpest ideological division within social democracy was between revolutionism and revisionism. Revisionists questioned the necessity of revolution to achieve SOCIALISM, arguing instead that it could be achieved within democratic electoral systems since, with universal franchise, the working class would form the majority of the electorate. The most famous supporter of revisionism was Eduard Bernstein, who fought unsuccessfully to persuade the German SPD to adopt a revisionist programme in 1899 and 1903.

As the first industrialized nation, by the end of the nineteenth century Britain had one of the strongest labour movements and one of the highest levels of TRADE UNION membership. The origins of the Labour Party, however, predate KARL MARX (and (until the adoption of a socialist constitution in 1918) Marxism played a limited role in the party. Indeed, the early history of the labour movement in Britain was strongly influenced by the apolitical ethos of craft unionism and the middle-class intellectual socialism of the Fabians.

The growing strength of revisionism and the support that most social democratic parties gave to their respective national governments during World War I, resulted in a sharp deterioration of relations between COMMUNISTS and social democrats. Consequently, the inter-war period was a time of ideological uncertainty and change. When social democrats entered government for the first time, most adopted conservative economic policies to cope with the GREAT DEPRESSION. Nonetheless, change was imminent. The identification of social democratic parties with the WELFARE STATE and full employment emerged largely as a result of the ideas advocated by the economist JOHN MAYNARD KEYNES and the success of public-expenditure programmes adopted by the Swedish SAP from 1932.

With the economic prosperity that followed World War II, most social democratic parties became more moderate in their political ambitions. Between 1958 and 1960, social democrats in Scandinavia, Holland, Germany and Austria embraced Keynesianism and the welfare state as a means of reconciling the contradictions between capitalism and socialism (see KEYNESIAN ECONOMICS). This ideological change was most clearly exemplified in the Bad Godesberg Principles, adopted by the German SPD in 1959, which called for 'as much market as possible ... as much planning as necessary'.

While social democracy's greatest triumph in Britain was the landslide victory the Labour Party achieved under Clement Atlee in 1945, the party remained deeply divided over the pace and form that public ownership of the means of production should take. Although the Atlee government had nationalized key industries such as coal and steel, radicals wanted to proceed further, while revisionists felt this would only destabilize the economy. Echoing sentiments that would later be expressed at Bad Godesberg, Anthony Crossland argued in his famous work *The Future of Socialism* (1966 [1956]) that, as a result of adopting a mixed economy and Keynesian economic policies, Britain was no longer 'capitalist', consequently socialists should aim not for the creation of a socialist state but to use growth to ameliorate continuing inequalities in society.

The end of the post-war boom in the 1970s saw the return of mass unemployment and INFLATION. In Britain and Sweden, this coincided with a much greater radicalism in economic policy by social democratic governments. The resulting economic crises and union militancy led to the beginnings of a political and ideological backlash. Beginning in Britain with the election of the Conservative Prime Minister Margaret Thatcher, social democratic governments were slowly replaced with conservative ones committed to the New Right policies of NEO-CLASSICAL ECONOMICS and the 'roll-back' of the welfare state. Such was the right's success that, by the time of the defeat of the French Socialist Party in 1993, Spain was

the only large country with a social democratic government.

With this decline in support came a renewed period of ideological uncertainty. The electoral triumphs of conservatism combined with the collapse of communism in Eastern Europe and the Soviet Union, left social democratic parties adrift. The problem for social democratic parties now that they have entered the twenty-first century is that arguably they belong to a party system whose origins lie back in the industrial revolution. Class dealignment and the decline of traditional manufacturing point to systemic change in that system. As a result, a number of social democratic parties have recast their appeal towards the growing middle classes. Borrowing heavily from the electoral triumph of the Democrats in the United States in the 1992 presidential election, the British Labour Party under Tony Blair has championed a so-called 'Third Way' between the neo-classical economics of conservatism and the policies of the old left. Shedding previous commitments to public ownership and socialism, critics have argued that the 'New' Labour Party is barely distinguishable in policy from its opponents on the centre-right. Nonetheless, since 1996 social democratic governments or coalitions have returned to power across the Western world, including the United Kingdom, France, Italy, Germany and Sweden.

See also:

Keynes, John Maynard; Keynesian economics; social democracy; trade unions

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JASON P. ABBOTT

social limits to growth

The concept of social LIMITS TO GROWTH focuses on the extent to which social congestion and physical limits impede economic growth. While the notion of limits has its origins in the work of ADAM SMITH and THOMAS MALTHUS, it has been raised in more recent times by individuals such as Harrison Brown, Paul Ehrlich and Dennis Meadows and his colleagues, who warn of impending scarcities and privation. Others (such as Herman Kahn and Julian Simon) insist that such limits do not exist. The most detailed and sophisticated examination of the concept can be found in Fred Hirsch's 1977 book, *Social Limits to Growth* (1995 [1977]).

Physical limits to growth

How much and how rapidly can human societies grow within physical FACTOR ENDOWMENTS? Biologists have found a direct linkage between the food supply available to a species occupying an ecological niche and the number of individuals in a distinct population group. When, for whatever reason, the numbers of individuals in a population tend to outstrip food supply, a population crash and greatly diminished numbers will soon follow. Some have extended this rather straightforward

social limits to growth

process to human numbers and warn that unrestrained POPULATION GROWTH, CONSUMPTION or both will, sooner or later, deplete available supplies of food, RAW MATERIALS and COMMODITIES, with concomitant results.

Although Malthus was probably not the first to make an argument of this sort – and his concern was with the social treatment of the poor rather than resource limits as such – his formulation remains the best-known and most widely critiqued. Nevertheless, the fundamental principle underlying his work remains valid: a constant annual percentage ('geometric') increase in any quantity – whether population or output – ultimately leads to runaway exponential growth. Clearly, all else being equal, if one quantity (such as population) grows at a higher rate than another (such as the supply of food), the quantity of food available per individual will drop until starvation sets in (or the rich monopolize the food supply, as is often the case in famines). At that point, the social limits to further population growth would appear to have been reached.

Malthus committed two errors in his analysis, one of which was addressed by Adam Smith. In a market setting, a decrease in the supply of a good relative to demand should lead to a higher price for the good, followed by either a subsequent increase in supply or a shift in demand to other comparable goods. If, however, there are no substitutes (as is the case for water) or if the price for a non-substitutable good rises too high, thereby putting it out of the reach of the poor, the 'laws of supply and demand' will not apply. The second error (one that neither Malthus nor Smith could have foreseen but which is usually offered by optimists as a trump card) are recent high rates of growth in agricultural productivity for reasons having to do with TECHNOLOGICAL CHANGE (the GREEN REVOLUTION) and a phenomenon sometimes called 'dematerialization', which occurs as economies shift from heavy industry to services.

Subsequent efforts to examine the prospects of supply and demand for food and commodities, such as the famous 1972 Club of Rome report *Limits to Growth* that was conducted at

MIT by a team led by Dennis and Donella Meadows, have adopted largely the same methodology as Malthus and foundered on similar shoals. Based on reserve/consumption ratios, Meadows *et al.* predicted that (at the then current rates of economic growth) supplies of raw materials would be depleted by the middle of the twenty-first century. The 1973 Arab oil embargo suggested to many, moreover, that depletion might set in much sooner (although it has not). As a consequence, subsequent studies of potential physical limits to growth have been subject to withering criticism, as seen in the work of Herman Kahn and Julian Simon, with the consistently declining prices of commodities during recent decades being pointed to as evidence that supplies are not running out and that limits to growth do not exist. There are good reasons to doubt that the price of a commodity in world markets has very much relation to its absolute supply, and a lot more to do with TERMS OF TRADE, but (for the moment) absolute material limits to growth seem a fairly distant prospect.

Limits to pollution

Until now, Malthus has been wrong in the general case, but there remain good reasons to heed his warnings. Put briefly, a second concern involves the capacity of the natural ENVIRONMENT to absorb pollution. Within the ideologies of the nineteenth and twentieth centuries, social survival has been thought to require consistent economic growth – historically in terms of national populations, industries and territories; more recently as measured by annual increase in the GROSS DOMESTIC PRODUCT (GDP) of states. With such growth have come growing levels of pollution and environmental degradation.

These limits to pollution are manifest at two rather different scales. At local to regional levels, effluents from industry, transportation and agriculture can have serious impacts on public health and quality of life. As the London smog of 1954 and declining life expectancy in the former Soviet Union suggest, beyond a certain point not only growth, but

also life, is impossible. Such local pollution can, experience seems to suggest, be reduced to tolerable levels through regulation, technology and market mechanisms.

At the global level, however, such limits may be rather more intractable. For example, the production of greenhouse gases – carbon dioxide, methane, chlorofluorocarbons and so on – from fossil fuel combustion and other industrial processes, appears to be causing measurable changes in the earth's climatic system. What the outcome of this 'experiment' will be remains unclear, although there is a broad consensus that some parts of the planet will become hotter, wetter, dryer or more vulnerable to serious storms and flooding. At the extreme, a few scientists worry about a 'tipping effect' in which sudden, unanticipated emissions of carbon dioxide from existing reservoirs could lead to a 'runaway' greenhouse effect, under which conditions would become inhospitable to human life. Were this to happen, adaptation would be difficult, if not impossible.

The possibility of limits to pollution has not, as yet, led to the effective restraint of the practices that could bring human societies up against those limits. For the moment, the prospective near-term costs and the resistance to paying them by countries and various interests have been sufficient to stymie collective and concerted action along the lines of, for example, the United Nations (UN) climate convention (see GLOBAL WARMING (UN CLIMATE CHANGE CONVENTION)).

Social limits to growth

The argument presented by Hirsch is quite different from those described above. While Hirsch readily acknowledged that raw materials might become scarce and pollutants excessive, his analysis centred on a critique of the social limits inherent in market-based economic growth and the COMMODITY FETISHISM it has fostered. He began his analysis by considering the conventional political promises offered on behalf of growth-based liberal market systems: a continual expansion in the

size of a national economy, as measured by GDP, implies a growing share for each member of the society. In absolute terms, everyone will grow wealthier, even if each person's relative wealth does not increase, and this will provide even the less wealthy with access to more prestigious goods and employment. Thus, while Bill Gates' wealth grows faster than Joe Sixpack's, even the latter will see improvement over time so long (of course) as inflation does not erode the purchasing power of his incremental gain. Finally, because increased wealth makes it possible to consume more goods which, in turn, make people happier, economic growth contributes to political and social stability, which is also desirable (especially for the economic and political elite).

One problem with this version of the good news is that it is possible for a market-based society with high rates of economic growth and low inflation to actually see absolute gains by all members of a society, with wealthier members enjoying high relative gains and poorer ones experiencing relative losses. This arises, in part, from each individual's initial factor endowments and investment opportunities, as well as their access to those parts of the economy in which innovation and growth are the greatest. A society with overall high growth rates may be driven by a rapidly growing service or electronics sector in which owners and workers are growing wealthy, while also possessing a slowly growing or even declining heavy industry sector in which wages are increasing but losing ground relative to the more wealthy. This seems to have been the case in the United States, beginning in the middle 1970s and continuing until very recently.

Hirsch, however, was concerned with another problematic aspect of liberal economic growth and the social limits it imposed, which he called 'the hole in the affluent society'. Specifically, he pointed out that proponents of the growth-led society promise that, eventually, all members will be able to acquire those goods and jobs that, heretofore, were available only to society's wealthiest members. As noted above, a consistent degree of absolute economic growth is supposed to enrich even the poorest and, at

social limits to growth

some point, enable them to purchase luxury cars, second homes and advanced college degrees. Indeed, many have argued that it is this very promise that has fostered social peace and stability in democratic market-based societies: the guarantee that, by hewing closely to the rules of society, one will be rewarded in this life, rather than the next.

The hole, according to Hirsch, arises from what can be called 'social congestion'. Those luxury or POSITIONAL GOODS coveted by every member of the affluent society are, of course, readily purchased at an early date by the wealthy. They can buy a costly car and enjoy the freedom and comfort it offers when there are few other vehicles on the road. Even in the absence of inflation, however, by the time the last member of society can afford to purchase even the most basic car, motorways will be filled with the vehicles of all those who bought earlier, and travel by personal car will be a chore rather than a pleasure. The same applies to higher education. If a college degree is required to find a high-paying, high-status job, those who graduate later will find themselves at the end of a long queue and, inasmuch as not everyone can be a king or CEO, they will have to settle for less-prestigious, lower-paying positions. As Hirsch put it:

The concentration of economic growth in the material sector of the economy increases the relative price or reduces the unit quality of goods and facilities available in the positional sector. This tendency makes one's place in the distribution of income, wealth, and economic power a determining factor in providing access to goods and facilities that are socially scarce. Because they are allocated by an auction process or its equivalent, relative rather than absolute command over economic resources deployed in the auction will determine one's take. This struggle for relative shares, or positional competition, will also absorb real resources that add to the consumption expenditures necessary to achieve given ends, and in this sense add to 'needs'. So, if one's own income remains unchanged while the income of other people

rises, one's command over the positional sector will fall. The income that earlier supported a downtown apartment, a country home, the acquisition of elite educational qualifications, or simply an active life protected from the crowds, is no longer sufficient.

(Hirsch, 1995 [1977]: 102)

Hirsch argued that the fundamental contradiction in liberal market-systems was, therefore, the system's lack of connection between social needs and individual interests. A failure to address this contradiction would, in all likelihood, lead to social instability, fostered not by those at the lower end of the income scale but, rather, by groups in the middle and upper-middle classes who would see their hopes and dreams dashed and engage in a distributional struggle for relative gains. The result would be, as he put it, 'to displace Smithian harmony by Hobbesian strife' (ibid.: 185).

What is to be done? One response, propounded by economic libertarians, is to simply remove the distributional issue from the political agenda and let the chips fall where they may: those who do not succeed will have failed only by virtue of their individual shortcomings. A second possibility is to reduce the distributional stakes by imposing controls on positional goods. If all cars costing more than \$25,000 are banned from the market, there will be less prestige associated with ownership and fewer resources expended on luxury cars. A third alternative, proposed by Hirsch, is to address the problem at its source – at the level of individual competition – by reducing the benefits or increasing the costs associated with positional goods and jobs. Thus, for example, salaries for high-status jobs could be reduced – a step that should, in principle, reduce demand for such positions and alter the composition of the applicant pool.

Whether this last approach would have the desired effect is not entirely clear. Relatively speaking, academic salaries are commensurate with their supposed status only in those disciplines (such as economics and business) where there is serious competition with the

private sector. Over the past two decades, moreover, a relative decline in pay scales for other academic disciplines does not seem to have tempered competition for available positions. This might be explained by SURPLUS CAPACITY in the production of Ph.D.s, as well as a decline in expected retirements and new openings. At the same time, the availability of high-paying jobs in the software industry and the appearance of software barons such as Bill Gates and his stock-option-rich employees have not led to the expected flood of computer-programming graduates (in part, according to some, because writing code is 'boring'). This does not undermine Hirsch's argument, although it does suggest that social congestion may be rather more complex than he thought.

There may also be a darker side to the LAISSEZ-FAIRE attitudes and policies of the 1980s and 1990s. Hirsch assumed absolute gain in incomes accompanied by positional struggle; he did not foresee the possibility of absolute losses by the middle classes (see CLASS, MIDDLE), as the gap between rich and poor grew wider and markets began to cater to a smaller, but much more wealthy, upper-income tier. Those most dangerous to the social order are not the destitute, who are too busy looking for their next meal; it is the well-educated, who find their prospects in decline and, lacking alternatives, are willing to test their ideas in the streets.

See also:

alternative development; casino capitalism; change, progressive; deindustrialization; demographic trends; distribution of income; Schumacher, E(rnst) F(riedrich); niche specialization; Polanyi, Karl; quality of life: Sen, Amartya Kumar; sustainable development; tragedy of the commons; trickle-down

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RONNIE D. LIPSCHUTZ

social market

The term 'social market' or 'social market economy' (*soziale Marktwirtschaft*) originates in the German neo-liberal tradition of political economy and was used by Ludwig Erhard, the architect of West Germany's *Wirtschaftswunder* (economic miracle), as the astonishingly successful political label for his economic policy programme from 1948 onwards.

Even within German neo-liberalism there is much disagreement on the meaning and content of 'social market economy'. The person who coined the term, Alfred Müller-Armack, considers the 'social' and the 'market' as antithetical ordering principles that have to be balanced and reconciled in a 'new synthesis'. The 'free' market is a construct that can be engineered to deliver the required amount of wealth, which can then be redistributed by government in the name of social JUSTICE and equality of opportunity. There is more than a passing resemblance here to John Rawls' (1971) concepts of distributive justice.

Arguably, Müller-Armack's conception is quite close to the popular view of the social

market in Germany and elsewhere, advocating activist social policy measures to compensate for the operation of market forces, to redistribute wealth in society, and to maintain social consensus and solidarity. Müller-Armack's social policy programme, for example, includes a 'complex and complete' system of social security, state subsidies for small businesses and vocational training, co-determination in the workplace, and the use of countercyclical policy to ensure full employment. However, this view has little in common with the classical liberal tradition and sits rather uncomfortably with the views of other German neo-liberals, including Erhard himself.

The core of German neo-liberal thought is found in the writings of the Freiburg School of Law and Economics, especially associated with the economist Walter Eucken and his legal colleague Franz Böhm. Eucken emphasizes an *Ordnungspolitik* or 'policy of economic order'. The state is charged with setting up and maintaining crucial supply-side regulatory functions, including (1) a monetary policy geared to price stability, (2) general rules of conduct to uphold private property rights, enable a price system to function and keep markets open, and (3) an anti-trust policy to combat market-distorting monopolistic activity. However, the state should not interfere with the price-signalling and resource-allocation mechanisms of the competitive economic process through price controls and other interventions in the freedom of production and consumption. Thus *Ordnungspolitik*, involving 'order' maintenance by the state while refraining from 'process' interventions in the market, is inextricably linked to the defence and extension of the free-market economy.

The Freiburg School is as much about law as it is about economics. To Franz Böhm, the legal cornerstone of a free-market economy is a 'private law society', emphasizing the general rules of conduct of private law as a key regulator of transacting and contracting activity in the market.

To Eucken and Böhm (and to Erhard during his long period of office at the helm of West German economic policy), social policy is not

conceived in an activist, redistributive sense. First and foremost it is supposed to be a market-oriented *Ordnungspolitik*, integrating as many individuals as possible into market society. The proper application of *Ordnungspolitik*, they believe, should enable the economic order to function well and reduce social problems to a minimum. As far as social policy in the narrow sense is concerned, it is supposed to provide a basic, minimal safety net for those who remain unintegrated in market society.

The Freiburg School does not have much to say on the subject of social policy *per se*, but there is a 'sociological' side of German neo-liberalism (particularly associated with Wilhelm Röpke and Alexander Rüstow) that sees the 'social' in a very different light to the redistributive focus of Müller-Armack. Röpke and Rüstow regard the social framework, along with the Rule of Law and a free-market economy, as part of a wider organic whole, not a redistributive device to 'correct' the imperfections of a mechanical market. To them, social cohesion is not a matter of activist government policy, but rather something that spontaneously emerges 'from below', nurtured by traditions and conventions in the 'natural' communities of the family, church and localities. The emphasis is on self-help, self-responsibility and civic-mindedness, all of which form the moral framework conditions 'beyond supply and demand' (in Röpke's words) that envelop and sustain economic activity in the marketplace. This accords closely with Erhard's conception of the social market. Furthermore, the combination of Freiburg-style *Ordnungspolitik* and sociological neo-liberalism following Röpke and Rüstow can be regarded as a continuation and reformulation of the classical liberal tradition in the lineage of ADAM SMITH, David Hume, Edmund Burke and Alexis de Tocqueville.

Erhard and his neo-liberal friends clung to social market economy as a political programme, albeit one rather different from the popular perception of social market economy today. Nevertheless, there is a classical liberal objection to the term 'social market', especially in its redistributive connotation, that is tren-

chantly put forward by HAYEK. He argues that redistributive 'social justice', involving discretionary government action to confer privileges on some groups at the expense of others in an arbitrary political game, is incompatible with the 'spontaneous order' of the market, which is based on general rules of conduct and self-organizing properties. To him, the 'social' is a 'weasel-word', devoid of theoretical meaning and easily amenable to political manipulation to satisfy a plethora of interest-group demands.

See also:

ideology; liberalism

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RAZEEN SALLY

social organization of production

The purpose of the social organization of production is to organize the factors of production (capital, labour and natural resources) for the initiation and development of production. Such social organization of pro-

duction also involves political and social circumstances. Social organization of production refers not only to firms, but also to the organization of whole societies. In the Marxist view (see MARXISM-LENINISM), the social organization of production is characterized by a social relation of domination and subordination between capitalists and workers. That means that through the control of the means of production the capitalists also dominate and control the workers.

In the context of IPE, the neo-Gramscian approach (Rupert, 1995 – see NEO-GRAMSCIANISM) argues that the reorganization of capitalist production on a global scale in the twentieth century, as well as related socio-political developments, make possible new kinds of practice that explicitly transcend national boundaries. Labour and production have become increasingly mobile globally through the activity of transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) who have sought to minimize costs by breaking the bargaining power of the workers or their unions and moving to more lower-cost production locations to increase their profitability.

See also:

relations of production

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MEHDI PARVIZI AMINEH

social policy

The meaning of the concept 'social policy' is perhaps better understood by academics who

write about it, than by politicians and activists who shape it, officials and professionals who implement it, and the people who are meant to be the beneficiaries of it. It is also relatively unusual to hear the term used beyond academic circles. These observations assume a unanimity of understanding about the concept and betray a bias towards a particular conceptualization. Yet among academics there is a lack of consensus about what the concept means, and especially about its boundaries. Outside Europe, it is common for the term 'social welfare' to be used instead of 'social policy', with the latter term reserved for descriptions of the academic study of social welfare – especially as it has developed in the United Kingdom.

Within Europe (and particularly within the United Kingdom), there might be some consensus about the proposition that fundamentally social policy – to use the term in a collective sense – is a system of public interventions to protect, maintain and enhance a society's welfare. But while the notion of welfare provides the defining core focus of social policy, it is arguably an ambiguous concept. Such ambiguity makes it difficult to establish a boundary around what might be referred to as social welfare and hence to establish what might constitute social policy. It is useful, though, to regard the concept of social welfare as a continuum. At one end of the continuum the policy focus would be on perceived social needs and, at the other, the focus would be more inclusively on the *well-being* of a society. Policy intervention in the areas of health, social security, personal social services, housing, employment, water, sanitation and food have the most direct impact on social needs. Other aspects of policy activity, in the areas of transport, leisure, the environment, consumption, technology and the arts, for instance, might arguably be more concerned with the *well-being* end of the welfare continuum.

Political, social and economic processes determine which aspects of social welfare are identified as legitimate areas for policy intervention. Such processes also determine the

character of state intervention in the system of social welfare, ranging (for instance) from universal to selective – or means-tested – provision and from direct provision to the regulation of other producers of welfare-resources (such as the private market, employers, voluntary organizations, trade unions, churches, families, friends, communities and individuals for themselves). Dominant ideological perspectives – such as concerns about equity, efficiency, freedom, citizenship, justice and rights – also shape the character of social policy.

Among academics there is disagreement about whether the study of social policy constitutes a discipline or a field of study, as there is arguably no distinctive methodology and methods of enquiry. As a field of academic endeavour, social policy is therefore defined more by *what* is studied than *how* it is studied. However, there is an increasing use of comparative cross-national policy evaluation and the construction of typologies of social-welfare systems has also dominated academic activity. Academics studying social policy (or social welfare as it might alternatively be called) are an eclectic congregation, many trained in disciplines across the social sciences and utilizing perspectives from politics, economics, sociology and philosophy, in particular. The study of social policy is arguably not a value-free activity. Despite their disagreements about the boundaries of the field, most social policy academics share a commitment to action leading towards a just society, although conceptions of justice differ.

See also:

welfare: welfare state

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PAUL G. HARRIS

social value theory

'Social value theory' is a set of propositions designed to critique and transcend the positivistic, utilitarian theories of value that underlie mainstream, neo-classical, liberal economic theory (see POSITIVISM; NEO-CLASSICAL ECONOMICS; LIBERALISM). It is part of the post-modern and constructivist debate within social science about the nature and source of actors' preferences and the role of normative theory (see POST-MODERNISM). It asserts that from the utilitarian or Pareto perspective of mainstream economics, there are no normative criteria by which to judge or measure value – all actors' preferences are given equal weight in the market. Utility is measured through the quantitative balancing of pleasure and pain using Bentham's 'hedonistic calculus' – that is, utility is a function of the intensity, duration, certainty and propinquity of the net pleasure experienced. The price each actor is willing to pay for a good is a measure of the utility derived from it. Preferences are given and actors respond mechanically to shifts in market-determined prices. Inter-personal and inter-group comparisons of utility are impossible.

Social value theorists fundamentally challenge this utilitarian approach to political economy. They argue that people do not have innate preferences; rather, human conscious-

ness is shaped by social experiences that create a mix of beliefs and incentives including (but not limited to) self-interested hedonism. Individuals are creators and creatures of the social milieu in which their preferences are formed. Since actors shape and are shaped by their social environments, the utilitarian emphasis on maximization of fixed individual preferences and their separation of cause and effect and of preferences and outcomes are inappropriate. Normative and positive theories of political economy cannot be separated and a social value theory becomes necessary.

Social value theory is rooted in radical approaches to political economy based on the work of both neo-institutionalist scholars (including Clarence Ayres, John Dewey, and Marc Tool) and Marxist scholars (including William Ash, Maurice Cornforth and Bertell Ollman). While Marxist approaches to social value theory emphasize the ends or 'ideal states' that are desirable (namely, COMMUNISM), neo-institutionalist scholars focus on process and change, and the question of how to distinguish random change from 'progress'.

Mark Tool, for example, defines social value theory as that 'which provides for the continuity of human life and the non-invidious recreation of community through the instrumental use of knowledge' (Tool, 1979: 293). This definition builds on two neo-institutionalist insights of John Dewey and Clarence Ayres: (1) culture and social relations are essential for human development and (2) the WELFARE STATE tends to overemphasize distribution and consumption at the expense of achievement and creativity. Competition in the market creates invidious social antagonisms that lead to unnecessary inequality, deprivation and wastefulness. These, in turn, distort individual personalities. Therefore, Tool argues, the role of the economy should be to provide and encourage the development of individual personalities, culture and community without disrupting them. For social value theorists, providing criteria for adjusting institutions to do so in light of social and technological change should be the primary analytical task of political economy.

socialism

See also:

labour theory of value; Marxism- Leninism; value theory

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GEORGE E. SHAMBAUGH

socialism

The notion of socialism has given rise to a diverse number of definitions, ideas and movements. Socialists offer alternative but divergent forms of economic organization that attempt to overcome the defects of industrial CAPITALISM. These can range from a fully planned economy to a more mixed economy, combining public and private provision. Most socialists see the need for extensive forms of state intervention and regulation of the market.

The term 'socialism' originates from the writings of the utopian socialists of the 1830s: ROBERT OWEN in Britain, and Henri de Saint-Simon and Charles Fourier in France. Utopian socialists posited alternative future societies, free from the EXPLOITATION and dehumanization that they believed was symptomatic of capitalism. Owen and Fourier based such socialist utopias on small-scale communities, whereas Saint-Simon offered a more national and even international utopian vision. For all these thinkers, only in a utopia can human beings develop to their full potential.

Marxist socialism (see MARXISM-LENINISM) developed in opposition to this utopian variant from the 1840s. KARL MARX and Friedrich Engels saw the value of utopian socialism in its attack on the operations of the capitalist system. However, the utopian socialists were

guilty of building 'castles in the air' – ignoring the importance of the day-to-day struggles of the working class in trying to overturn the capitalist order (see CLASS, WORKING). Accordingly, Marxist socialism emphasized the importance of a class-conscious proletariat actively overthrowing capitalism and instituting a socialist society with the eventual aim being COMMUNISM.

Emphasis on the self-emancipation of the working class meant that Marx was reluctant to offer blueprints of what a future socialist society might look like. After all, this was precisely the criticism he levelled at the utopian socialists. However, he did indicate what the political economy of socialism might contain. He mentioned such measures as the socialization of production in advanced capitalist societies; the public provision of health, education and welfare; and distribution according to contribution. Additionally, he stressed the importance of socialism being international and not confined to one country if it was to be successful. However, there was no clear indication of how a socialist economy might actually function.

While stressing the need for a revolutionary working-class movement, Marx also suggested that more peaceful methods could achieve socialist aims. The First International (1864–76) and the Second International (after Marx's death, 1889–1914) divided on this issue of reform versus revolution. The non-revolutionary road to socialism typified the debates within the German Social Democratic Party (SPD) up to 1914. Leading figures of the party (such as Eduard Bernstein) adopted a 'revisionist' position, arguing for an evolutionary STATE SOCIALISM that would achieve reforms by using the political institutions of capitalist society. Violent revolutionary activity was deemed necessary only for defence against illegal reactionary forces. Even so, within the German SPD, radicals such as ROSA LUXEMBURG still argued for the revolutionary road to socialism.

It was with LENIN and the BOLSHEVIKS in Tsarist Russia, however, that the revolutionary road to socialism was vigorously adopted and

successfully executed in 1917. This act was meant to encourage other countries, in particular Germany, to instigate socialist revolutions themselves. The failure of such an outcome left the Bolsheviks isolated in a Russia with only a limited economic base that was mostly concentrated in agriculture. Renaming themselves the Communist Party, the Bolsheviks instituted the Third International in 1919, which led to the affiliation of Communist Parties in the rest of Europe.

The conventional understanding of socialism as a system of economic planning was initially begun in practice by the Bolsheviks through 'war communism'. Private enterprise was outlawed and resources distributed centrally. The chaos this created, especially at a time of civil war, led to the abandonment of central planning and the introduction in 1921 of the NEW ECONOMIC POLICY (NEP). The NEP still ensured that large-scale industry, banking and foreign trade remained under state control, but allowed the peasantry to own land and to sell produce on the market. Even the majority of state enterprises were allowed to engage in production for the market, rather than being directed by a central plan. By 1928, however, planning was back on the agenda in the shape of the considerably ambitious Five-Year Plans that were designed to rapidly increase the industrialization of the Soviet system. Socialist planning was therefore seen as synonymous with a rigidly directed centralized economic system in which markets had no place. Rapid industrialization required all enterprises and firms to be told what, when and how goods should be produced and delivered. The state's attempts to coordinate all economic activity gave rise to the conception of state socialism that epitomized the Soviet system in particular and socialist planning in general.

One crucial implication for the notion of socialism during this period was Stalin's argument for SOCIALISM IN ONE COUNTRY. Despite Marx's own emphasis on the importance of socialism being international and the replication of this idea in the works of Lenin and Trotsky, socialism became confined to the level

of the NATION-STATE. The economic gains of national planning were undeniable, with an almost doubling of production between 1928 and 1938. The social gains were more debatable, however, with living standards held constant and collectivization resulting in mass famine. By the mid-1970s, planning was being increasingly regarded as inadequate for ensuring economic growth because of incentive and information problems. The severe crisis in the Soviet economy in the 1980s, coupled with the advent of Mikhail Gorbachev, resulted in the overthrow of the old system. The emphasis, in principle, was now on a free market economy totally unsullied by socialism.

The Soviet socialist experiment, based on rigid economic planning, contrasted with the form socialism took in the West after World War II, as SOCIAL DEMOCRATIC PARTIES began to take power. Socialism was interpreted not as a system of economic planning, but as a balanced combination of public and private provision within the capitalist system. Keynesian demand-management policies were adopted ostensibly to guarantee full employment and sustained economic growth, and WELFARE STATES were created to ensure the health and well-being of citizens. A mixed economy, rather than a bureaucratically planned society, was equated with this type of socialism.

The crisis of Keynesianism in the 1970s and 1980s (see KEYNESIAN ECONOMICS), however, led to the widespread adoption of neo-liberal policies (see NEO-LIBERALISM). Nationalization strategies were discredited as they led to overcapacity and inefficiency. Keynesianism had resulted in STAGFLATION and the state seemed persistently unable to successfully intervene in the market to ensure growth and stability. In response, some socialists developed the approach of MARKET SOCIALISM. The perceived failure of the Soviet economic system and a recognition of the value of some aspects of the market economy, led economists such as Alec Nove to argue that markets and socialism were not necessarily incompatible. The positive aspects of the market in terms of consumer sovereignty and the efficient allocation of

socialism in one country

resources could actually be combined with minimal economic planning to create a socialist society and so end capitalism. What differentiated market socialism from the standard mixed-economy approach was the absence of large-scale private ownership of the means of production. Instead, the economy would consist of state-owned enterprises, co-operatives and small firms. To overcome the bureaucracy of the COMMAND ECONOMIES, planners would be held accountable to a democratically elected body. The tensions between planning and the use of the market, and the extent of state intervention in the economy to try and ensure socialist goals are the subject of continued debate.

The increased internationalization of capital has led to a re-emphasis on the need for international socialism. A strategy adopted by some socialists has suggested the use of common European policies through the European parliament to raise funds for investment in social and economic programmes. A socialist Europe could then act as a base for a more integrated form of international socialism. Similarly, writers such as IMMANUEL WALLERSTEIN have stressed how the internationalization of capital has made the idea of a world government more feasible – even necessary. Socialists building on his work have stressed how the organizations for world regulation established by the dominant economic powers can be taken over for a socialist, rather than a capitalist, world government.

Socialism has, therefore, a rich variety of approaches that differ in the ways, means and extent of their desire to alter the capitalist system. Socialists vigorously support and oppose reform, revolution, economic planning, the free market, socialism at the level of the nation-state and international socialism. Consequently, the apparent success of the capitalist system and the failure of ‘actually existing socialism’ does not mean that the notion of socialism is anachronistic. As long as capitalism exists, socialists from a variety of approaches will be ready to offer critiques of it and thereby posit alternative ways of organizing society.

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IAN FRASER

socialism in one country

The doctrine of ‘socialism in one country’ was in its origins a political rather than a theoretical blow delivered in the struggle against Leon Trotsky in the intense battles which divided and finally transformed the Communist Party of the Soviet Union in the 1920s. Stalin first advanced or raised the idea in December 1924 as the most obvious alternative to Trotsky’s theory of PERMANENT REVOLUTION. This argues that revolution was more likely to occur in backward Russia, but that SOCIALISM – understood by Trotsky to mean a classless society – could only be created after

CAPITALISM as a world system had finally been destroyed. Stalin disagreed, though largely it seems for tactical reasons. The theory of socialism in one country did not emerge in a vacuum. As Trotsky noted, it was the 'only theory that consistently and to the end opposed the theory of permanent revolution' (Carr, 1970: vol. 2, p. 45). Once created, however, the doctrine took on a life of its own and soon became the official ideology of the international communist movement. It also served to justify Stalin's subsequent economic policies. Indeed, both collectivization and industrialization were validated at the time on the grounds that they were critically important to the construction of socialism in Russia. To this extent, Stalin's costly economic strategy was the necessary and logical result of his earlier efforts to destroy Trotsky and bury the theory most closely associated with Trotsky's name.

If Trotsky was the original reason for the doctrine of socialism in one country, he was also its most tireless critic and, in a series of polemics written between 1924 and 1940, persistently attacked the idea. He did so on at least five grounds. First, in his view, the doctrine would inevitably lead to a subordination of the wider revolutionary movement to the foreign-policy needs of the Soviet state. It was also an economic nonsense and could only conclude in disaster. Over time it would moreover spawn a new form of Russian NATIONALISM, though dressed up this time in a demi-Marxist rather than a feudal garb (see MARXISM–LENINISM). Socialism in one country would, in turn, generate exaggerated claims about Soviet achievements. Finally, by identifying the fate of Soviet Russia with the idea of socialism, the doctrine would in Trotsky's opinion seriously erode the wider appeal of socialism.

Trotsky's highly influential critique (whose influence went far beyond the narrow bounds of his own political entourage) did little, however, to undermine the theory of socialism in one country or change Soviet practice. In fact, the more Trotsky attacked the idea as a nationalist deviation which ran counter to both classical Marxism and the laws of the modern

WORLD ECONOMY, the more the Soviet leadership sought to justify the doctrine. They did so in the first instance by citing the early LENIN against Trotsky, suggesting (incorrectly) that Lenin no less was the originator of the idea. They also tried to draw a quite scholastic distinction between socialism – which was deemed feasible in Russia – and full communism – which was not. Finally, and most critically perhaps, they pointed to what many accepted as a self-evident truth: that there really was no alternative under conditions of capitalist encirclement. In fact, some analysts have gone so far as to suggest that the success of the idea owed less to its polemical value and more to the fact that it seemed to offer some form of hope or comfort against the growing despair at the prospects for European revolution. Hence, if socialism could be established in one country – even without the complete victory of the Western proletariat – then the Soviet Union need not feel impotent. All was not lost after all. On the contrary, the more the Soviet Union reconstructed itself along socialist lines, the greater the impetus this would give to socialist movements elsewhere.

Ideologically suspect though the idea may have been, socialism in one country did have a certain underlying logic and clearly did make sense to millions of people at the time. Moreover, in spite of Trotsky's cerebral attacks to the contrary, the strategy did seem to work. Russia was industrialized rapidly. Nazi Germany was then resisted and defeated – albeit at huge cost. After the war, the system was transplanted elsewhere in Eastern Europe. Even a number of new elites in the THIRD WORLD saw merit in the notion of trying to develop an independent socialist system outside the world economy. Indeed, like the Soviet leadership in the 1930s, they too could see no serious alternative to socialist planning if they wanted to overcome the legacy of backwardness and march boldly forward with head held high.

Yet, as Trotsky anticipated, the short-cut, the fast-track path to the new society, was so riven with contradiction that it was only a matter of time before the whole thing came tumbling down. And if Trotsky can be merited

socially useful production

with one idea – and one idea alone – it was the observation that no amount of political bravado or false statistics could hide the fact that the system originally created in the USSR in the 1930s simply could not survive over time. That it did for so long speaks volumes about the endurance of the Soviet people, not to mention the plethora of political controls the elite had at its disposal to contain and repress potential dissent. However, as Trotsky foretold, the USSR (like Eastern Europe and before it China) could not buck the world market. The pull was simply too great. Fortunately, when the end finally came, it was with a whimper rather than a bang. The longest, and possibly costliest, detour in history was over.

See also:

Marxism-Leninism; Trotskyism

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MICHAEL COX

socially useful production

The idea of ‘socially useful production’ emerges from Marxist and other critiques of CAPITAL-

ISM. These claim that the capitalist MODE OF PRODUCTION is far from optimal in meeting human needs. The term emerged in the 1980s following a campaign by trade unionists employed by Lucas Aerospace in the United Kingdom. Working through their trade union combine organization, they developed a workers’ alternative plan that proposed to substitute socially useful products such as energy conservation systems, public transport vehicles and healthcare equipment for Lucas Aerospace’s military production.

Proponents of the strategy of socially useful production challenge the notion that the INVISIBLE HAND of the market leads to production systems that maximize the use of labour and current technical knowledge, arguing instead that much of the output of production for profit is frivolous or harmful. In Marxist terms, they argue for the production of use-values rather than exchange-values, and theirs is a fight against abstract labour.

Throughout the nineteenth and early twentieth centuries, socialist thought had fastened on the injustice of concentrations of power and wealth (see POWER; SOCIALISM); on the struggle for universal suffrage and working-class parties, and on the right to control the means of production in order to overcome EXPLOITATION and eradicate inhumane working conditions. Socialists were concerned with tackling ALIENATION in the form of the degradation of the worker, not with tackling the quality or usefulness of output. However, by the 1970s a number of strands of thought could be drawn on by the Lucas stewards and trade unionists at Vickers, Rolls Royce and elsewhere who put forward the notion of socially useful production.

Writers concerned with Marxist VALUE THEORY claimed that much labour in capitalist economies is unproductive – for example, carrying out tasks that relate to the circulation of money or the maintenance of the social order. This position was developed by writers like PAUL BARAN and Paul Sweezy to argue that in ADVANCED CAPITALIST societies there is enormous non-productive use of resources. John Ruskin, William Morris and later utopian

socialists argued that under capitalism humanity is increasingly denied the opportunity to engage in useful (and beautiful) production. Only the artist has the opportunity to practise unalienated production, to experience human-kind's pleasure in labour.

Partly inspired by anarchist and other thinking on self-sufficiency, the alternative technology movement in the 1970s claimed that advanced industrial societies were generating technologies that were centralizing social control and despoiling the environment, and that technologies that were more amenable to democratic control were ignored by capitalist firms.

Proponents of alternative technology argued that the needs of working-class communities in deindustrializing local economies were written off (see DEINDUSTRIALIZATION). Meanwhile, trade unionists facing factory closures had adopted strategies such as occupations and work-ins in the hope of saving jobs. This led to a debate about workers' control and workers' cooperatives within the trade union movement. Faced with lack of market demand for their production, these workers questioned the logic of a system that could leave needs in their communities unmet, yet render the workers themselves redundant.

In the post-war period, writers concerned with world DEVELOPMENT observed that capital export to developing countries displaced (often unhelpfully) existing production systems. They proposed 'intermediate technologies': technologies that were more productive than indigenous systems, but less expensive than advanced technologies, and would fit more smoothly into local social structures and ecosystems.

Writing in the Marxist tradition, Harry Braverman (1974) reintroduced the issue of the labour process and DESKILLING, observing that technologies were often aimed more at control of the producers than at useful and efficient production. Fears of deskilling increased with computerization in the 1970s and 1980s. Workers' plans emphasized both socially useful output and empowerment, rather than control of the worker. Also in the 1970s, a

movement concerned with social responsibility in science emerged which recognized that technological change was socially determined. Socialist activists questioned the assumption that COMMUNISM was a matter of workers' control of existing technological systems, rather than an exploration of new directions for technical change. The Lucas Plan was also influenced by proposals to 'beat swords into ploughshares' that had been put forward by the peace movement. These conversion projects (see CONVERSION OF ARMS INDUSTRY) aimed to safeguard jobs in areas dependent on military production.

The Lucas Plan was developed partly in the face of defence expenditure cuts, rationalization and GLOBALIZATION, partly in response to a debate inside the factories about what NATIONALIZATION of the Aerospace industry (the policy of the UK Labour government at the time) might mean to the workforce (Wainwright and Elliott, 1982). The realization that the capitalist marketplace could not generate an economic demand for socially useful production led to discussions about state intervention. The plan and many of its originators became influential in local government in England in the 1980s, where a model of municipal socialism was developed. The term 'popular planning' was used in opposition to modernist-inspired national policies – workers' plans could be drawn on to meet the needs of deprived communities and provide jobs, thus regenerating local economies.

The Lucas Plan was undermined by the retreat from radicalism of the Labour government, by organizational weaknesses in the combine, by the suspicion and intransigence of some sections of the national leadership of the unions, by the coming to power of the Conservative government and the subsequent reduction of trade union power in the 1980s, and by the retreat from municipal socialism by Labour-controlled local authorities.

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MIKE QUIGGIN

society

Society is one of the most widely used concepts in any language. The term 'society' crops up everywhere in the media, academia, the arts, government debate and in everyday conversation. In addition, as Anthony Giddens says, 'It is one of the most important of all sociological notions' (Giddens, 1993: 746). Yet it is one of the vaguest of general terms, both in and out of the human sciences. Making sense of the concept of 'society' is made more difficult because everyday assumptions, common-sense interpretations and popular images obstruct its real meaning. Going beyond common-sense, as well as getting behind the jargon in the socioeconomic and political sciences, is necessary if there is to be a productive dialogue between disciplines.

Making sense of the meaning of 'society' requires: (1) clear definitions; (2) an identification of societal types; (3) a delineation of the main orientations; (4) a shorthand review of the major theories of society.

Definitions

According to Giddens, 'Society is a system of interrelationships which connects individuals together. No cultures could exist without societies' (ibid.: 32). Elsewhere he states:

Society is a group of people who live in a particular territory, are subject to a common system of political authority and are aware of having a distinct identity from other groups around them. Some societies like those of hunters and gatherers are very small, numbering no more than a few dozen people. Others are very large, involving many millions – modern Chinese society, for instance, has a population of more than a billion individuals.

(ibid.: 746)

A more graphic definition is that of Peter Berger:

We are located in society not only in space but in time. Our society is an historical entity that expands temporally beyond any individual biography. Society ante-dates us and it will survive us. It was there before we were born and it will be there after we are dead. Our lives are but episodes in its majestic march through time. In sum, society is the walls of our imprisonment in history.

(Berger, 1966: 108–9)

Later in the same text, he adds:

The walls of our imprisonment were there before we appeared on the scene, but they are ever rebuilt by ourselves. We are betrayed into captivity by our own cooperation.

(ibid.: 141)

Much earlier, MacIver and Page referred also to the fact that people rebuild their own walls, stating, 'Social beings express their nature by creating and re-creating an organization which guides and controls their behaviour in myriad ways' (MacIver and Page, 1953: 5).

It is clear that the above definitions implicitly refer to society as structure and as process. The structure consists of the major

cultural institutions and value systems which control and regulate society. The process of society is to do with those social changes and interrelationships that occur within it and help to create adaptations and innovations.

Explanatory frameworks

In addition to the definitions, there are explanatory frameworks or constructs. Like the lens of a camera, these help theorists sharpen their focus by identifying both the structure and process within society.

'Turning things inside out' is a common expression for understanding how anything works. It is also possible to refer to 'turning things outside in'. Making sense of society when considering the walls society builds for people is in effect to turn the concept 'outside in'. It is also possible to turn the concept 'inside out' by taking into account the walls people build for society. When making sense of society, three pairs of concepts facilitate such analysis (see Anderson, 1994a: 163–8). These coupling concepts are:

- 1 representation and reality
- 2 global and local
- 3 public and private

The concepts of *representation* and *reality* enable people to construct contrasting value-laden images of society on the basis of their life experience. For example, the deprived describe their experience of deprivation as living in an unjust society. In contrast, the affluent will describe it as living in a free and just society. The concepts of *public* and *private* serve to define the boundaries between the state (public domain) and the rest of society (private domain) and their very different spheres of activity. The concepts of *local* and *global* help to sort out the small societal (local) and the wider societal (global) milieux. The study of the impact of centres on peripheries within society is facilitated in this way. One can compare local and global differences in the European Union (EU) or the relationships between central and peripheral societies in the

Third World. Economic and political dimensions prevailing in a society are more easily identifiable by making use of such coupled concepts.

Types of society

There have been a number of major attempts to classify society. The earlier nineteenth-century theorists made a sharp distinction between the more simple societies and the more complex industrial types. A plethora of types have been suggested by many authors from the nineteenth century onwards, such as non-literate and literate, pre-modern and modern, or pre-industrial and industrial societies. One of the first commentators on society was Emile Durkheim (1933). He contrasted earlier pre-industrial societies, which he described as 'segmental', with later industrial societies, which he described as 'organic structures'. The former were local societies that were largely simple and homogenous, having much in common. The latter societies were made up of complex differentiated parts, which were heterogeneous, but interdependent, making up one organic whole.

More recent authors identify the difference between modern and post-modern societies (see Kumar, 1995; Sarup, 1993; also MODERNITY; POST-MODERNISM). It suffices here to delineate the broad differences between them in societal terms. Post-modern society is closely related to post-industrial society. Daniel Bell (1973) provided the major text on *The Coming of Post-Industrial Society*. He explains how the production of goods in a technological society replaces the mass-produced, standardized products of an industrial society with its limited choices. They are replaced by myriad innovations and multiple choices facilitated by new technologies. Also, in the sphere of the production of ideas, Scott Lash (1990) describes how the grand meta-truths are challenged and deconstructed, followed by multiple reconstructed alternatives. Post-modernity draws the global and the local together through the technology of satellite and technotronic communication.

It used to be said, 'think globally, act locally'. Now, the statement is reversed: 'think locally, act globally'. The world has become a global society. The post-modern era is also perceived to be one of flexible specialization and multiplication of choices open to users and consumers, in what is also described as POST-FORDISM by such writers as Piore and Sabel (1984) and Jameson (1984). Other authors – Jameson (1984) again and Mandel (1975) – refer to post-World War II society as a 'late capitalist society'. As shall now be shown, the major types of society are incorporated into one of several orientations or traditions of social thought.

Social orientations: major traditions of social thought

The conceptions and constructions of what society is, have been handed down from generation to generation within particular cultures. These are usually reducible to four major orientations, which are associated with:

- 1 liberalism
- 2 conservatism
- 3 Marxism
- 4 social reformism

(see Anderson, 1994b: 191–202)

These have influential ideas about what human society is (its social structure) and how it develops (its social process).

Liberalism defends the liberty of people's freedom from state interference and regulation/control. Jean-Jacques Rousseau (1712–78) proposed that CIVIL SOCIETY or society was superimposed on the state of nature in which freedom was a central factor. Society prospers when the freedom of the market is conserved. Individuals know what is best for them. John Locke (1632–1704), in his *Treatises on Government* (1690), was most influential behind these notions. *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) by ADAM SMITH (1793–90) was a publication which also had a major influence within liberalism. Later, a more interventionist approach was heavily backed by

JOHN STUART MILL (1806–76), who set out his ideas in *Representative Government* (1861).

Conservatism agrees that inequalities are innate, but also stresses that human nature is imperfect and in need of moral constraints. Traditional respect for authority of the state, church and family are critical factors in the survival of society. Edmund Burke (1729–97) contributed *Reflections on the Revolution in France* (1790), which had a major influence on the establishment of conservatism.

Marxism stresses that capitalist society is essentially unstable because its majorities are oppressed. The elitist class system exists for itself and profit, not for the good of the people. Workers should have democratic control over what is produced by the workers. KARL MARX (1818–83), in the *Communist Manifesto* (with Engels, 1848) and *Capital* (1867), was responsible for the major texts propagating the notion of a classless society.

Social reformism sees society as made up of different interest groups and institutions. The state acts as referee and regulates the private sector within a democratic system. The theorists support a mix between public and private provision and production. The aim is to reduce inequalities and create better conditions within society. *The General Theory of Employment, Interest and Money* (1936) by JOHN MAYNARD KEYNES (1883–1946) was the major text supporting the policy of state regulation within a just society.

Whereas these provided general or grand frameworks within which to study society and its needs, there is a need for specific explanations or theories.

Theories of society

A theory is a scientific explanation. Three mainstream theories regarding the nature of society are worth noting:

- 1 contract theory of society (Thomas Hobbes, 1588–1679; Jean-Jacques Rousseau, 1712–78)
- 2 social organic theory (Emile Durkheim, 1858–1917)

3 biographical theory (Peter Berger and Brigitte Berger – see Berger and Berger, 1976)

The *contract theory of society* proposes that society is dependent on establishing a contract by which the parties who agree to it forego their dominant interests and independence, and in return secure mutual benefits. Hobbes' *Leviathan* (1651) broke free from the notion of society as an object of statecraft – a notion associated with medieval absolutism that smacked of Machiavellism. For Adam Smith, society was an artificial creation for the maintenance of mutual economy and benefit between people and government (see MacIver and Page, 1953: 42). Rousseau's *The Social Contract* (1762) prepared the way for the notion of people and government acting in a coalition of interdependent partners.

The *social organic theory* regards society as a kind of organism, as a biological system. According to Emile Durkheim, society's cells are individuals and its organs are its associations and institutions. Just as the body is made up of heterogeneous parts, so too is society made up of diverse entities, but is one unity with one head (Durkheim, 1938). The explanation comes close to adopting a social genetic model, in that individuals are mere resultants of the features of society or of what society makes of them. Hence, Homans refers to the 'social mould theory' (Homans, 1968: 317), which describes the conditioning of people's lives in society.

The *biographical theory* (Berger and Berger, 1976) stresses that 'society is our experience with other people around us' (Berger, 1966: 13). Based on experience, society is 'out there', surrounding individuals. However, it is also 'inside' the individual in that s/he plays,

the dramatic parts in the grand play of society, and, that speaking sociologically, s/he is the mask that s/he must wear to do so.
(*ibid.*: 123)

In this way, individuals learn their roles, movements and scripts, which they internalize, and 'in this way the structures of society become the structures of our own consciousness' (*ibid.*: 140).

Conclusion

The major definitions, types, orientations and theories of society, as discussed in the socio-political texts, provide different conceptions of society and enable social scientists to make sense of the various types of society. In turn, they also have considerable influence on the way people perceive and experience society and the way the social sciences, economics and politics are dealt with in social interpretation, and economic and socio-political analysis.

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Socioeconomic Democracy (SeD)

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The major texts by Durkheim (1933, 1938), Homans (1968) and MacIver and Page (1953) are cited because they provide seminal sources for the discussion of the structure of modern society, its groups and major institutions. Giddens (1993) is also included because his analysis of society is perhaps the most widely quoted in the United Kingdom. The focus on *the person in society* and *society in the person* is provided by Berger (1966) and Berger and Berger (1976). These major authors rivet our attention on the *experience of living* in society in biographical terms. Anderson (1994a, 1994b) extends our understanding of everyday experience by the use of the binary concepts global/local, private/public and representation/reality. Bell (1973), Mandel (1975) and Piore and Sabel (1984) are cited because they refer to socioeconomic changes introduced by the industrial to the technological era within late capitalism. In addition, Jameson (1984), Lash (1990), Sarup (1993) and Kumar (1995) look more closely at late capitalism and discuss the emergence of a post-modern society and its pluralist impact on contemporary culture. However, Giddens (1993) – one of the foremost commentators on society – prefers to talk of the ‘consequences of modernity’ rather than accept that there has been a wholesale shift from modernity to post-modernity.

GEORGE GIACINTO GIARCHI

Socioeconomic Democracy (SeD)

Narrowly interpreted, and as originally conceived, Socioeconomic Democracy (SeD) is a

theoretical model of the socioeconomic subsystem wherein there exists some form of both Universal Guaranteed Personal Income (UGI) and Maximum Allowable Personal Wealth (MAW), with both the lower boundary of personal material poverty and the upper boundary of personal material wealth set and adjusted democratically by all participants of society.

These two fundamental socioeconomic system parameters that are to be determined democratically within SeD enjoy a long list of advocates, including Paine and Jefferson, extending back to the ancient Greek thinkers and up to the present global quest for improved, more just economic systems. SeD adopts this well-established tradition and simply democratizes the possibilities faced by any society. This is accomplished by employing a central result of PUBLIC CHOICE (PC) THEORY – that is, the median value of participant preference distribution of any good is the democratically desired amount, with single-peakedness and majority rule. SeD thereby inaugurated public introduction to and adoption of quantitative democracy.

Many theoretical and practical aspects of SeD are suggested by its four possible democratically established variations: namely, some amount of UGI or zero UGI along with a finite MAW or an infinite MAW limit. The analysis of these four different, yet all fundamentally democratic, socioeconomic subsystems provides considerable insight into the unresolved problems of many past and present-day politico-economic persuasions, as well as theoretically resolving the dilemmas momentarily inhibiting the realization of these two important operating limits of the socioeconomic system.

A well-developed body of knowledge already exists regarding SeD. Crucial matters, such as economic incentives and self-interest, financial benefits and costs, theoretical justifications, politico-socioeconomic feasibility, practical political approximations to the ideal theoretical model, comparative relationships between SeD and various religions (both spiritual, for example, *Zakat* in Islamic economics, and

secular extinct or extant politico-socioeconomic systems), implementation considerations and the desirable impact of SeD on numerous serious societal problems, have all been explored. It can safely be anticipated, however, that far more insights into SeD await future realization.

More widely (and loosely) interpreted, SeD refers to or includes that larger class of socioeconomic subsystems wherein other significant societal system parameters are democratically set. For example, possibilities include the societally desired magnitude of a maximum wage/income, a minimum wage/income, max-to-min ratio of incomes, amount of personal wealth and/or income below which a participant of a democratic society is not subject to any wealth and/or income taxes, and so on. The 'corruption' of the original specific meaning of SeD to this more general application of quantitative democracy, while perhaps regrettable, is no doubt inevitable.

The first book-length description of SeD was published in 1972. Both as a specific system and as a general perspective, SeD clearly refers to a post-modern and future-oriented political economy as opposed to backward-looking political economies.

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ROBLEY E. GEORGE

soft loan

'Soft loans' are concessional finance, usually for DEVELOPING COUNTRIES, where the borrower is allowed to pay interest at a rate below what would be charged on a commercial loan; the borrower may also be given a longer repayment period than a commercial lender would offer. Soft loans are particularly important for providing finance to poorer devel-

oping countries, such as those in SUB-SAHARAN AFRICA (SSA). A major source of soft loans is the INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA) of the WORLD BANK.

See also:

debt crisis; severely indebted low-income countries (SILICs)

JOHN THOBURN

sogo shosha

Japan's multinational trading companies, known as the *sogo shosha*, have played a strategic role in the competitive success of Japanese corporations. Their role is regarded as being so significant that some analysts have viewed them as the 'vanguard' of the Japanese economy and a key to Japan's massive expansion in international trade in the post-war period (Kunio, 1984; Young, 1979).

The story of the *sogo shosha* is intertwined with the rise of Japanese conglomerates, known as the *zaibatsu* in the pre-war years and the *keiretsu* in the post-war period. These conglomerates – Mitsui, Mitsubishi, Sumitomo, Yasuda – have been characterized by a business strategy that differs from the liberal market model. Central to the strategy is a high degree of integration between manufacturing, mining, banking, finance and trade, all articulated so as to maximize international competitive advantage.

The *sogo shosha* are a key element in this competitive process. They are powerful multinational trading companies dealing in a diverse range of commodities. For example, Mitsubishi is involved in the purchase, sales, export and import of coal, petroleum, gas, iron, machinery, food, fertilizer, textiles, wood and chemical products. They promote the interests of Japanese companies through developing two-way trade. For example, iron ore is bought from Australian mining companies and Japanese-

solvency

produced mining and transportation equipment is sold to them.

The *sogo shosha* have also facilitated the relocation of certain parts of Japanese manufacturing into the cheap labour centres in Taiwan, Korea, Indonesia and China. The *sogo shosha* have played a role in the industrialization of South-East Asia through the links they formed with ethnic Chinese business leaders. These have often taken the form of joint-venture companies. Chinese leaders recognize that maintaining close ties with the *sogo shosha* is a way of gaining privileged access to new markets.

These companies have also been a key facilitator and manager of credit for Japanese companies on world markets. They constantly monitor the credit status of overseas client companies and are the risk-takers in global trade deals.

These trading companies have also functioned as a conduit of TECHNOLOGY TRANSFER from the West to Japanese manufacturers. They gathered and provided the relevant information to Japanese companies and thus became both consultants and purchasing agents in this vital area. They often mediated licensing agreements between Japanese companies and Western manufacturers.

In furthering these roles, the *sogo shosha* have been intimately connected with the political processes and state bureaucracy in Japan. During the economic crisis of the mid-1970s, they were the focus of much popular resentment and were accused of price manipulation and stock market speculation. They have also been accused of being *seisho* – giving donations and bribes to politicians and helping high-ranking bureaucrats start their second careers. Notwithstanding these tensions and difficulties, the *sogo shosha* remain a significant instrument in Japan's relations with the world trading system and international business.

See also:

Asian corporatism (AC); Confucian model of development; East Asian model

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ROB LAMBERT

solvency

'Solvency' refers to the ability of a firm or public institution to meet its external obligations or debts when due. Solvency has been a key issue in global finance, especially during the Third World DEBT CRISIS in the 1980s. Some experts claimed that debtor countries were illiquid, meaning that they had sufficient assets to repay debts but the assets were not available within the time-frame contracted with their creditors. Others concluded that many debtors were insolvent because they could not meet their obligations under any circumstances. The view that the debt crisis was a liquidity problem predominated. This diagnosis undermined calls for an international debt-management agency or for debt forgiveness.

PETER DOMBROWSKI

South Commission

The South Commission was established in 1987 under the chairmanship of Julius K. Nyerere. Its objective was to examine the problems of the economic SOUTH and to put forward an agenda for action.

The Commission was an independent body comprising twenty-eight prominent individuals from the South. It was financed from the South and located in Geneva. The Commission's term of office was for three years, during which time it produced its major report: *The Challenge to the South* (1990).

The report included a comprehensive analysis

of the problems facing the South and a framework for action to help the South. Recognizing the acute crisis faced by many DEVELOPING COUNTRIES during the 1980s, the report suggests that the South can overcome the challenges it faces individually and collectively. The framework for action comprised a three-part strategy: nationally, it called for self-reliant and people-centred development; collectively, it called for greater SOUTH-SOUTH cooperation as a means of mitigating unequal North-South relations; finally, it called for a reform of the international economic system, similar to the NEW INTERNATIONAL ECONOMIC ORDER (NIEO) proposals. The report did not anticipate the major changes which were to take place in the international system after 1989.

In 1995, the Commission gave rise to the South Centre: an intergovernmental body of developing countries for research and analysis on issues of development for the South and its collective institutions.

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ANNA K. DICKSON

South, the

'The South' was originally the collective name given to the non-communist, economically poor states. The term is now used interchangeably with the THIRD WORLD, LESS-DEVELOPED COUNTRIES (LDCs) or DEVELOPING COUNTRIES.

The origins of the group can be traced to the assertion of the principle of self-determination

in the NON-ALIGNED MOVEMENT (NAM) and the quest for economic development after political independence. The South was most outspoken in its demand for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) in 1974. The underlying ideology, derived from the dependency school, was that the international system operated against the South's interests and that through collective action they could change it. In an era of open confrontation, the North found itself increasingly outnumbered in the United Nations (UN). In an attempt to counter this, France hosted a Conference on International Economic Cooperation in 1977, to which the socialist states were not invited. From this point onwards, the 'Third World' was replaced by the more politically neutral term 'the South'. With the demise of the North-South dialogue the term has become less precise.

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ANNA K. DICKSON

Southern African Development Community (SADC)

The Southern African Development Community (SADC) is a second-wave, post-apartheid regional organization which seeks to advance economic development for a growing number of member-states (now fourteen) in an increasingly divided part of the continent. Its predecessor – the Southern African Development Coordination Conference (SADCC) – was a

South-South

smaller (nine states), more modest but better funded arrangement to advance economic development while executing the anti-apartheid struggle, primarily around South Africa. The SADCC emerged out of earlier anti-settler groupings, like the Front-Line States, as Zimbabwe achieved majority rule in 1980. It featured a decentralized structure and received significant amounts of Western assistance. It expanded to ten members in 1990, as Namibia also became independent.

In turn, SADC emerged out of SADCC in 1992, as South Africa achieved majority rule and became the eleventh member. Africa's nearest NEWLY INDUSTRIALIZED COUNTRY (NIC) – the island of Mauritius – joined in 1995. Since the mid-1990s, the SADC has been plagued by two interrelated difficulties which may lead to its demise. First, it expanded its membership beyond the FLS/SADCC in 1997 to include the 'new' Congo and the distant micro-state of the Seychelles; such expansion may lead to dilution. Second, in the mid-1990s, it expanded its purview to include the strategic sector by establishing an Organ for Politics, Defence and Security at presidential level, in addition to the continuing ministerial-level Inter-State Defence and Security Committee (ISDSC). The ISDSC has been drawn into conflicts with the Organ for Politics, Defence and Security that have divided presidents and armies into two competing alliances. Meanwhile, South Africa – state, companies and civil society – remains the dominant military and economic force in SADC.

See also:

East African Community (EAC); Economic Community of West African States (ECOWAS)

Further reading

More details can be found on the web at www.sadc-usa.net/ or www.mbendi.co.za/or-sadc.htm

TIMOTHY M. SHAW

South-South

Based on the idea of collective self-reliance, South-South cooperation has been an objective of many THIRD WORLD states since the 1950s. South-South cooperation has evolved over the years in response to changes in the SOUTH, changes in the international system and changes in North-South relations.

The South forged a common identity through the DECOLONIZATION process. The ideological basis for this was both a perception of shared interests and the assumption that links with the North were not furthering economic development in the South. The formation of the NON-ALIGNED MOVEMENT (NAM) in 1961 and the GROUP OF 77 (G-77) in 1964 marked the beginning of collective action by the South on the international agenda, and led to the United Nations (UN) resolution on the NEW INTERNATIONAL ECONOMIC ORDER (NIEO) (1974). The South subsequently formed a number of political and economic links at the bilateral, subregional and regional levels.

Much intellectual energy and organizational effort has been expended on South-South cooperation, but the tangible results have been limited. South-South links have not displaced North-South links and the international economy has not been restructured. This deficiency has been attributed to the lack of institutional and technical support at the international level and insufficient national support.

Increasing diversity within the South may provide the economic rationale for greater cooperation; there are a growing number of regional and subregional groupings within the South as evidence of this. There are also possibilities for new areas of cooperation in shared resources and regional security. However, the IDEOLOGY which formed the basis for South-South cooperation has changed, with few states rejecting increased links with the North.

See also:

Organization of Petroleum Exporting Countries (OPEC); South Commission

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ANNA K. DICKSON

sovereign debt

Default on sovereign debt has caused concern in international financial markets for hundreds of years. The Latin American DEBT CRISIS of the 1980s mirrors the sovereign debt problems that bankrupted the Florentine financial houses of the Bardi and the Peruzzi in the fourteenth century.

‘Sovereign debt’ refers generally to international loans where the lender is unable to enforce its contract with the borrower through the typical means provided by domestic legal institutions. Specifically, sovereign debt refers to international loans where the borrower is the government of a sovereign state that can unilaterally free itself from its obligations to foreign creditors. The specific problem of SOVEREIGN RISK (the risk of default on a sovereign loan) exists because of the lack of a supranational system of contract enforcement.

In economic terms, sovereign borrowers are subject to MORAL HAZARD since they can default on loan contracts without bearing the full cost of this action. Because foreign lenders have only limited powers to enforce their contracts, the binding constraint on sovereign debt repayment is the borrower’s willingness to pay rather than their ability to pay.

Although sovereign debtors cannot be forced to repay loans to foreign creditors, there are incentives for them to pay voluntarily. A defaulting borrower may face a credit-rating downgrade, trade sanctions, be denied future access to international capital markets, or face higher interest rates on future loans. A borrower’s reputation is an important factor in determining the sovereign risk premium that is applied to international credit transactions.

It is in the borrower’s interest to create or to preserve a reputation for voluntary repayment.

The US Foreign Sovereign Immunities Act (FSIA) of 1976 formalized a process by which foreign borrowers may waive immunity in many commercial transactions. By strengthening creditor rights, these legal changes have made sovereign borrowing in the United States easier, although the problem of sovereign debt default has not disappeared.

MICHAEL VESETH

sovereign risk

‘Sovereign risk’ is the risk associated with the extension of credit to a sovereign government or to a private enterprise under a government guarantee. It forms a subset of country risk, which is one of those risks associated with doing cross-border business. The chief factor involved is the likelihood of rescheduling or a moratorium (cancellation of debt) due to political or economic changes. The greater the risk, generally the higher the cost of initial lending; sovereign risk is the major factor in determining the ‘spreads’ (differences in interest rates) between a sovereign government bond and five-year US treasury bonds.

Formal methodologies for calculating sovereign risk underwent major development in the 1970s with the explosion in commercial banks’ EURODOLLAR lending to emerging market governments. The influence of sovereign risk analysis (calculated and sold by agencies such as Moody’s and Standard & Poor’s) has increased significantly since the ensuing DEBT CRISIS of the 1980s. Despite recent evidence that these risk estimations trail as much as lead market perception of risk, sovereign risk analysis continues to exert great authority over market activity and bond spreads.

See also:

debt default; debt management (DM); London Club; Paris Club

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STEPHEN GREEN

sovereignty

Sovereignty is an attribute intrinsically linked within international relations (IR) to the notion of the STATE as a political actor. Sovereignty applies both internally and externally to the state. However, while the state may be 'sovereign' in the theoretical or legal sense, this does not automatically translate into either equality or autonomy with regard to other states. Indeed, sovereignty – while being the defining characteristic of international political organization – may be described as a contentious term, as the implication of absolute POWER associated with it is increasingly eroded.

Internal sovereignty refers to the legal right of the state to wield absolute authority within its territorial boundaries. External sovereignty means that the state is not subject to any higher jurisdiction, apart from laws or regulations with which that state voluntarily complies. Therefore, in theory, there is order within the state and ANARCHY between states. Sovereignty has a spatial identity as it corresponds to the territorial boundaries of the state; however, like the state itself, it can be described as a political abstract rather than a given fact. In order to be described as 'sovereign', states also require recognition as such by other states within the system. The sovereign state is eligible to participate within the international community; however, its legal status as a sovereign equal does not guarantee it the capacity to act. In other words, sovereignty is no guarantor of power.

Sovereign states all have human populations, some members of which form governments. It is these governments and officials who exercise sovereign authority in the name of the state

and who are responsible for its constitutional organization. States which are subject to a wider constitutional authority (such as Texas being subject to the constitution of the United States) are not sovereign and therefore lack the capacity of international agency.

Sovereignty, in theory, allows for the autonomy of the state as exemplified by the BILLIARD BALL MODEL of IR. However, sovereignty also allows states to form alliances and agreements with other states which, far from eroding sovereignty, can act to enhance it. Sovereignty need not mean political or military isolation or economic AUTARKY.

Sovereignty has come under threat from a variety of sources within the modern international system. For instance, while international law holds that states are inhibited from interfering in the domestic affairs of other states, this has arguably been increasingly circumnavigated by the rise of transnational CIVIL SOCIETY. Interest groups within separate states may amalgamate in order to gain a voice on the international stage. This process is representative of links that bypass national governments completely. An example of this is the NON-GOVERNMENTAL ORGANIZATION (NGO), Amnesty International, which concerns itself with abuses of human rights. Such human rights issues are problematic for INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs) as such affairs are regarded as strictly being the domestic concern of national governments. Indeed, the sovereignty which protects a state from outside interference may condemn its citizens to misery. Also, terrorist groups – who may be motivated by political or religious ideology – can undermine the sovereign state, even though the sovereign state is traditionally deemed to hold the monopoly on the legitimate use of force.

Within the global political economy the rise of MULTINATIONAL CORPORATIONS (MNCs) can present a challenge to state sovereignty. Large MNCs are capable of extensive influence on the policies of governments, especially within the LESS-DEVELOPED COUNTRIES (LDCs), and economic might can outweigh legal sovereignty in terms of power. If a state is

dependent on an MNC for its prosperity, then it will adapt its state policy to accommodate that MNC. This can take the form of silencing dissident minorities or failing to enforce adequate environmental or safety regulations. It is also possible for the parent state of an MNC to use that MNC for its own political ends in the host state, therefore avoiding accusations of direct political intervention. This can also be done through supposedly apolitical NGOs. Such penetrations of states are representative of the cobweb model of IR, which is illustrated by a series of linkages facilitated by the growth of technology and communications and the increasing enmeshment of the global economy. These linkages have led to increasing GLOBALIZATION, both culturally and economically, which sovereign states are ill-equipped to resist. Sovereign borders also fail to act as protection against global environmental degradation such as pollution or global warming. The environment cannot be constrained by politically constructed boundaries.

It can also be argued that the rise of REGIONALISM within IR represents an erosion of political sovereignty, as member-states are increasingly subject to external law. However, these states voluntarily agree to the rules of regional organizations presumably because they deem the advantages of membership to outweigh the costs of isolation. It should also be recognized that, ultimately, if a state chooses to abandon membership then it is free to do so. Sovereignty also enables small or weak states to join together to highlight ISSUE AREAS which particularly concern them. For instance, the Alliance of Small Island States (AOSIS) focuses on issues of global warming and increases in sea level. Alone these states would struggle to be heard in the international arena; together their voice is greater.

It is a paradox within the modern world that while sovereignty is still a cherished attribute for the state in terms of legitimacy, its significance is increasingly eroded due to both internal and external pressures. While the state may still be recognized as the most important actor within IR, it has become increasingly

involved in a complex pattern of connections which may challenge its boundaries, identity and allegiances; this may ultimately render sovereignty a legal fact but a practical illusion.

See also:

realism; sovereign debt; territory

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ROY SMITH

Special Drawing Rights (SDRs)

The Special Drawing Right (SDR) is an international reserve asset first created by the INTERNATIONAL MONETARY FUND (IMF) in 1969. SDRs perform four functions in international finance: (1) they supplement official holdings of gold and foreign exchange as official reserve assets; (2) they are used for IMF transactions and operations; (3) they are the official unit of account for transactions by the IMF and some other international organizations; (4) the value of the SDR is used as the basis for some private international transactions. A total of 21.4 billion SDRs were allocated between the initial distribution in 1970 and the most recent allocation in 1981.

specialization, costs and benefits of

The SDR is defined as the value of a weighted basket of hard currencies. The currencies used and their weights are revised every five years based on exports of goods and services by IMF member-nations over the preceding five years. As of 1 January 1996, the value of the SDR was the sum of the following five currencies: 0.582 US dollar, 0.446 German Deutschmark, 27.2 Japanese yen, 0.813 French franc and 0.105 British pound sterling

The SDR has played several different roles in international finance since its creation in 1969. Initially the SDR was important because it represented a new form of international reserve asset. As the BRETTON WOODS SYSTEM began to unravel in the 1960s, some nations found themselves with an uncomfortably large share of their international reserves held in the form of US dollars. The advent of the SDR allowed nations to reduce somewhat their reliance on dollar reserves, which proved to be especially important when President Richard Nixon severed the link between the dollar and gold on 15 August 1971.

The SDR became important as a flexible form of international reserve asset in the 1970s, when rising petroleum prices and other economic shocks created large international payments imbalances. The creation of the SDR allowed the IMF to increase international reserves in response to the need for increased international liquidity. The SDR served as a flexible liquidity source, performing the function that JOHN MAYNARD KEYNES had originally proposed for the *bancor* currency unit (BCU) at the Bretton Woods conference.

Although SDRs are official reserves and may only be held by IMF-member central banks, they have nonetheless become an important factor in private transactions in recent years. The value of the SDR is more stable than that of any of its constituent currencies. SDR-denominated contracts, bank accounts, loans and bond issues have become relatively common as firms have sought to insulate themselves from the effects of foreign exchange volatility.

A new allocation of SDRs was being

considered by the IMF in 1996 to correct what was perceived as an uneven or inequitable pattern of SDR holdings, among both the thirty-eight nations that joined the IMF between 1981 and 1996 (and therefore had not benefited from SDR allocations) and the thirty-seven nations that participated in some or all of the SDR allocations between 1970 and 1981.

MICHAEL VESETH

specialization, costs and benefits of

Controversy surrounding the costs and benefits of specialization arises in international trade issues. For economic LIBERALISM, specialization of production is the fundamental rationale for FREE TRADE. By specializing in the area of production in which it has COMPARATIVE ADVANTAGE, a country can use its economic resources more efficiently and thus produce more than a state with a CLOSED ECONOMY (gains from specialization). Furthermore, by exchanging goods with the ones produced in other countries, a country can maximize its economic welfare with a given level of economic resource endowments (gains from trade). In that sense, foreign trade and specialization of production are mutually reinforcing.

On the other hand, adjustment costs arise from the fact that both capital and labour resources in the less competitive sector must be reallocated to the more competitive sector. Liberal economists recognize that specialization of production creates adjustment costs within each country and that the costs are relatively higher for workers who need retraining and education to be employed in growing sectors. Nevertheless, liberal economists consider adjustment costs to be a short-term necessity in order to achieve an overall increase in a country's economic welfare, and believe that overall benefits of specialization will be greater than short-term adjustment costs.

Different schools of thought challenge the

liberal view on the virtue of specialization by focusing on the cost of specialization in addition to adjustment costs. ECONOMIC NATIONALISM emphasizes that costs of specialization can function as a form of foreign manipulation, given that specialization increases what ROBERT KEOHANE and Joseph Nye called 'vulnerability' (see VULNERABILITY, ECONOMIC) – the opportunity for foreign countries to use a threat of trade sanctions to achieve political goals. Therefore, economic specialization across national borders can be potentially very costly, in particular if other countries produce strategically important goods such as oil and weapons. DEPENDENCY THEORY, on the other hand, emphasizes the possibility that specialization among countries perpetuates or increases asymmetric economic DEVELOPMENT between developed and developing countries. Since the logic of comparative advantage directs developing countries to specialize in primary goods, trade will instead restrict developing countries from becoming industrialized, while benefiting developed countries. Thus these schools of thought view specialization of production as potentially or actually costly, rather than beneficial, and advocate the use of STRATEGIC TRADE THEORY, INFANT-INDUSTRY PROTECTION or more drastic measures to change the international economic structure.

In practice, countries try to increase economic welfare by increasing economic specialization while limiting vulnerability to foreign influence. How to balance both goals is a dilemma for policy-makers.

See also:

autarky; division of labour; factor endowments; interdependence

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YASUHIRO IZUMIKAWA

speculation

How can we distinguish speculation from INVESTMENT? A rule of thumb is that speculation involves a higher than average risk of loss (and a commensurately higher level of return). Speculators use many HEDGING strategies to reduce risk of loss. In the most extreme cases, it is hard to distinguish some types of speculation from gambling. Financial economists defend speculation as a way of ensuring efficient allocation of scarce resources. Despite this defence, speculation (and hedge funds in particular) are alleged by some to create greater VOLATILITY in financial markets, increasing the risk of financial crisis.

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TIMOTHY J. SINCLAIR

SPECULATIVE BUBBLES see financial panics and crises; Kindleberger, Charles

spill-over

'Spill-over' refers to a process normally (but not exclusively) associated with the process of INTEGRATION, whereby the deepening of ties between states in one functional area leads to further integration. The notion of 'spill-over' is closely associated with the pioneering work of Ernst Haas in the late 1950s who, in response to inadequacies in the existing functionalist theories of integration (see FUNCTIONALISM),

spot market

contributed to the development of NEO-FUNCTIONALISM. Whereas functionalists, such as David Mitrany, would stress that the process of integration was largely depoliticized and technocratic, neo-functionalists explained the pressures for integration in terms of political responses to the pressures created by 'spill-overs'. Spill-overs presuppose that states are interconnected in such a way that problems in one area will raise problems (or require solutions) in another. In the beginning, such spill-overs will occur among different functional tasks but, as integration increases, they will affect more politically sensitive areas. For Haas, spill-over reflected the growing necessity of transnational or supranational structures as a response to the increasing transnational nature of problems faced by individual states. According to this rationale, integration will proceed gradually and incrementally across ever larger territorial entities, encroaching on the SOVEREIGNTY of existing political structures and necessitating the pooling of sovereignty into supranational authorities.

See also:

federalism

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JASON P. ABBOTT

spot market

A 'spot market' is a market in which goods or securities are traded for immediate delivery. This is distinct from a FORWARD MARKET, in which promises to trade at some future date at fixed prices are bought and sold. Hence the SPOT PRICE for a good is the price for immediate delivery. An example of a spot market is the spot exchange market. Here,

when currencies are bought, the transaction takes place immediately. It is in this market that exchange rates (see EXCHANGE RATE) are kept at their managed levels by government intervention.

See also:

foreign exchange; market

ALISON M.S. WATSON

spot price

The 'spot price' is the price for immediate delivery of goods or securities bought in the SPOT MARKET, as opposed to the FORWARD MARKET. The riskiness of spot prices is one reason that forward markets exist. For example, the owner of a tin mine might know that they will have one ton of tin to sell in twelve months' time. One option is to sell the tin at the spot price this time next year. However, the seller cannot be sure today what the price next year will actually be and might make a loss. The seller can hedge against such a risk (see HEDGING) by selling instead in the forward market.

See also:

speculation

ALISON M.S. WATSON

Sraffa, Piero (1898–1983)

Piero Sraffa was the outstanding Italian economist of his generation. Born in Torino, he studied economics at the university there, and wrote his thesis on the inflation in Italy during and after World War I. His supervisor was Luigi Einaudi, a liberal, who became president of the Italian republic after World War II. In 1919, Sraffa met the leader of the Italian communist movement, ANTONIO GRAMSCI, with whom he had a personal and

political relationship. After he had finished his thesis in 1920, Sraffa worked for a bank for a short period. He then decided to go to the London School of Economics and attended lectures of the economist Edwin Cannan on the history of economic thought. At this time, Sraffa met JOHN MAYNARD KEYNES for the first time. Keynes became aware that this young Italian economist had worked on monetary theory and history, and the contact with Keynes would become very beneficial for Sraffa. Sraffa had published a less academic version of his work on Italian monetary policy in the *Manchester Guardian*. This article stirred up the anger of the Italian fascist leader Benito Mussolini, who had just come to power: he called for the withdrawal of the article, but in vain. In spite of this, Sraffa started his academic career in Italy with positions in Perugia and Cagliari. During this time, he was working on Marshallian economics and from this came the article 'Sulle relazioni fra costo e quantità prodotta' which appeared in 1925 in the *Annali di economia*. It was Keynes who encouraged Sraffa to write an English version for *The Economic Journal*; in 1926, 'The laws of return under competitive conditions', appeared and it is still a classic. Although it contains some important extensions to the theory of IMPERFECT COMPETITION, it is less rigorous and fundamental than the 1925 article (which has been translated into several European languages, excepting English). During that time, Sraffa felt increasingly uncomfortable with the political situation in Italy. So when the Faculty of Economics and Politics in Cambridge, at the suggestion of Keynes, asked him to accept a lectureship, it was a rare honour and the beginning of an outwardly quiet, though intellectually stimulating, life.

From 1927 on, Sraffa lectured in Cambridge on the theory of prices and on money and banking. However, he disliked lecturing (although not teaching in general). Keynes helped him to get the position of first librarian of the Marshall Library and from 1935 to 1963 Sraffa was Assistant Director of Research, which meant he was in charge of the research students. In 1939, he became editor of the

Royal Economic Society edition of the works of DAVID RICARDO. In the same year, he became Fellow of Trinity College, where he lived until his death.

Sraffa's critique of Marshallian economics

It is common knowledge, even to amateur economists, that demand and supply determine prices. This law is symbolized by the Marshallian cross, drawn in a diagram with the price on one axis – the 'ordinate' – and the quantity on the other – the 'abscissa': the quantity demanded is a decreasing function of the price, while the quantity supplied increases with the price. The supply curve is derived from the cost curve, which again originates from a technical relationship between inputs and outputs – the 'laws of return'. The production of commodities obeys the law of diminishing return and leads to rising cost curves and, therefore, to rising supply curves. But there are also commodities which are produced under conditions of constant or even increasing returns. In his 1925 article, Sraffa showed that (with certain exceptions) only constant returns (that is, constant costs) were compatible with the Marshallian assumptions for the analysis of competitive markets.

The law of DIMINISHING RETURNS was used to explain the rent of land. The successive doses of capital/labour to land can never lead to increasing returns, because land is divisible and isolated producers will, if they have only little capital/labour, choose the technique that yields the highest average return. With successive doses of capital/labour, they will cultivate more land, always using the method that yields the highest average return, until the entire land is under cultivation. As long as some land remains uncultivated, there are constant returns. Diminishing returns occur if the entire land is intensively cultivated by additional doses of capital/labour. Diminishing returns are always due to a fixed factor and, if the industry under consideration shares this factor with other industries, the level of supply will then depend on the demand for the fixed factor by the other industries. This implies that the

ceteris paribus condition is violated. But if the scarce factor is specific to an individual firm, a monopolistic element creeps into the analysis – for example, a specialized land, like a special vineyard within a special district. But the commodity ‘wine’ is not homogeneous because the input ‘vineyard’ is not homogeneous.

Increasing returns are incompatible with the assumption of competitive industries if returns are internal to the firm. At given prices, a profit-maximizing firm would plan to build up an infinitely large size of plant because, with the increasing size of the plant, average costs decrease. The firm would then supply an infinite quantity at given prices. This does not constitute a competitive and stable industry structure. In the case of increasing returns, there is only one exception: if there are external returns that cannot be controlled by the individual firms. In this case, the diminution of average costs depends on the size of the market and/or the number of firms, but not on the technical conditions internal to the firms. There would then be constant returns, as assumed by Marshallian economics. The Marshallian rising supply curve is, therefore, a rather special case, while a horizontal supply curve due to constant returns seems to be normal under competitive conditions. While Sraffa’s 1926 article, mentioned earlier, leads to the theory of IMPERFECT COMPETITION developed by Joan Robinson and Edward H. Chamberlin, Sraffa himself did not pursue this line of thought.

On money and capital: Sraffa’s debate with Hayek

Sraffa’s debate with F.A. VON HAYEK emerged from Keynes’ discussion with Hayek about Keynes’ *Treatise on Money* (1930). Hayek had pointed to the missing capital-theoretic foundations in the *Treatise* and accused Keynes of having ignored the Böhm-Bawerk–Wicksell approach. Keynes felt ‘that the abyss yawns’ and encouraged Sraffa to publish his attack on Hayek’s *Prices and Production* (1931). It was never Sraffa’s style to criticize theories from

outside, which would mean questioning their assumptions. As in his critique of Marshallian economics, he focused on the internal consistency of Hayek’s theory. Sraffa uncovered a contradiction between the implications of Hayek’s intertemporal theory and the monetary rule that Hayek wanted to establish. This rule – well known from Knut Wicksell – is to keep the money rate of interest in line with the natural rate in order to avoid disequilibrium between saving and investment, because such a disequilibrium causes inflationary or deflationary processes. This rule has to be applied in disequilibrium, but in disequilibrium there is no unique natural rate of interest: there are as many natural rates as there are commodities. So to which of these natural rates should the money rate be adjusted by the central bank? It seemed that Sraffa understood Hayek’s theory better than Hayek did himself. Hayek could not reject Sraffa’s argument and this caused more harm to Hayek himself than it did to his inconsistent theory, since the core of the Wicksell–Hayek theory is still alive; for the development of economic theory, the reverse would have been more desirable.

Sraffa as editor of Ricardo

Sraffa’s edition of the works and correspondence of David Ricardo is beyond all doubt an editorial masterpiece. Sraffa took over the Ricardo project at the LSE in 1929–30 from Professor Gregory. He went to great pains and overcame many doubts to render his Ricardo edition as complete and philologically correct as possible. He traced lost manuscripts and letters, and provided explanatory notes concerning the background of almost every conceivable aspect of Ricardo’s activities. In Ireland in 1943, a fortuitous discovery was made: Ricardo’s letters to J.S. MILL, together with other manuscripts. One of these manuscripts was the uncompleted final essay ‘On absolute value and exchangeable value’, which caused Sraffa to revise all but one of the volumes that had already been set as page-proofs, integrating the new discoveries into the

page-proofs and, of course, increasing the number of planned volumes accordingly.

In 1945, when Austin Robinson became Secretary of the Royal Economic Society, the project of the Ricardo edition was more than fifteen years old and still incomplete. Austin Robinson asked Maurice Dobb to assist Sraffa and Sraffa overcame severe psychological problems to issue nine volumes in 1951, while the tenth – *Biographical Miscellany* – and eleventh volumes – the index – were still in preparation. Volume 10 appeared in 1955, with Volume 11 following in 1973. The index is a masterpiece of scholarship in itself, because it indirectly provides an interpretation of Ricardo's theory. Moreover, it is admirable for its completeness and is a great help towards understanding Ricardo's terminology. The success of this Ricardo edition was overwhelming and it is regarded as one of the great triumphs of economic scholarship.

Sraffa's introduction to Ricardo's *Principles* (1817) offered a new perspective on classical and particularly Ricardian economics. His interpretation of Ricardo's theory challenged the Marxian as well as the orthodox view (see MARXIAN ECONOMICS), according to which Ricardo was a predecessor of the supply-and-demand approach but overemphasized costs of production and therefore the supply side. Sraffa, however, showed how Ricardo used the concept of surplus in the theory of distribution and that he confined the principle of rent (extensive and intensive) to non-reproducible means of production.

Production of commodities by means of commodities

After the success of the Ricardo edition, Sraffa began to complete *Production of Commodities by Means of Commodities* (known as PCMC), for which some important ideas had already been developed in the late 1920s. It should first be mentioned that, if this book had appeared after the discussions on the laws of return, its impact on the development of economic theory would have been rather different. When it was published in 1960, its conceptual ideas were to

some extent overlooked. Some of the early reviews only observed that it contained results already well known from the theory of linear models but disguised in old-fashioned terminology. It took a number of years before its conceptual depths began to be unfolded.

In PCMC, Sraffa provided a general equilibrium framework which permitted an explanation of the forces that determine the prices of commodities in the long run and under competitive conditions without recourse to the supply-and-demand analysis of NEO-CLASSICAL ECONOMICS. Neo-classical GENERAL EQUILIBRIUM theory considers exchange of commodities between different and independent economic agents to be the core of economic analysis. Production is outlined as a one-way transformation of (primary) inputs into consumption goods and distribution is reduced to pricing of (primary) factors. Accumulation is analysed in an intertemporal setting and again exchange remains the core of the analysis, but now in terms of intertemporal exchange. Exchange and the generalization of the principle of rent at the intensive margin, together with given factor endowments, characterize the neo-classical general equilibrium approach.

Sraffa, however, returned to the classical (particularly the Ricardian) method of analysing values and prices by regarding as given the structure of production – as embodied in the technical means of production and the level and composition of output – as given. If the economy produces a surplus, the distribution of the surplus between wages and profits and the structure of relative prices are not independent of each other. In the classical analysis of distribution and prices, the surplus principle is the core, while the principle of rent (at the extensive or intensive margin) is only used where it seems appropriate (that is, for non-reproducible means of production, such as land, or exhaustible resources).

PCMC had a considerable impact on the course of economic theory in the 1960s and 1970s: the debate on reswitching and capital-reversing, the revival of interest in Ricardian and Marxian economics, and last, but by no

Sraffian economics

means least, the re-emergence of classical economics. Although Sraffa was the prime mover of this development, he did not participate in the debates. Nothing portrays his behaviour better than the following little anecdote: During high table dinner at Trinity College, two Fellows started a discussion on a topic treated by Sraffa in his PCMC. Sraffa, though present and aware of the discussion, neither intervened nor paid any attention to it.

Sraffa continued his work as librarian and could be seen walking along the Backs (where the River Cam runs behind the old colleges) or in the Trinity College garden. In his younger days, Sraffa went mountain-climbing and took long walks in the countryside. For a long period, he went on walks with Ludwig Wittgenstein, the famous philosopher. In the preface to his *Philosophical Investigations*, Wittgenstein acknowledged Sraffa's influence on his thinking. Sraffa's charm and simplicity of manner attracted many students and when he had become old, he was still visited by students from all over the world. He used to show them some of the treasures of his private library, such as his copy of the first edition of *The Wealth of Nations*, annotated by ADAM SMITH himself. It is well known that Sraffa was a bibliophile and most of his precious library has been inherited by Trinity College, where it can still be admired.

See also:

labour theory of value; neo-Ricardian (post-Sraffian) theory; Sraffian economics; value theory

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VOLKER CASPARI

Sraffian economics

The theory of value (relative prices) and distribution has undergone some significant changes since the days of ADAM SMITH and DAVID RICARDO. Modern economic theory explains prices and the distributive shares of national income (profits, wages and rents) by means of the theory of supply and demand. This theory was more or less simultaneously developed by ALFRED MARSHALL in England, the French economist Leon Walras and, to some extent, the Austrian economist Carl Menger. In the course of the development of economics, the ideas and concepts of these three economists merged and formed the framework of what has become known as NEO-CLASSICAL ECONOMICS. In the 1960s and 1970s, this approach was challenged by a critique set forth by PIERO SRAFFA in his book *Production of Commodities by Means of Commodities* (1960). Some main ideas in this book had already been developed in the late 1920s; they originated from his criticism of Marshallian partial equilibrium analysis. Sraffa's masterly edition of Ricardo's works was the second source from which some of his more constructive ideas seem to have emerged. Sraffa's approach is neither based on the Walrasian conception of GENERAL EQUILIBRIUM of de-

mand and supply, nor on the Marxian concept of labour values. Sraffa revived the classical method of analysing prices (and values) by regarding the structure of production as embodied in the technical means of production and the level and composition of output as given. According to Sraffa's approach, economic analysis does not start with the analysis of decision-making by individual agents (firms and households), but with the objective properties of an economic system that is capable of reproducing its means of production and providing at least subsistence to the people living in this system. A system, to be economically meaningful, must be assumed to be capable of producing commodities in excess of the commodities required as means of reproduction – that is, a surplus. Even for the case that Sraffa entitled 'Production for subsistence', the existence of a surplus is essential, as the people working in the system can only reproduce themselves by consumption if the surplus is at least non-negative. Let us assume that the surplus is positive and that one distributive variable – the rate of profits or the wage rate – is given, then relative prices are determined. Classical economists regarded the wage rate as given, which actually means that they considered wages as determined by the historically and institutionally given level of subsistence. From a present-day view, taking the importance and the impact of financial markets into account, one may regard the rate of profits as given, because we may consider the rate of profits as being determined by the rate of interest through the working of CAPITAL MARKETS. A little formal analysis will explain the interdependence of relative prices (values) and distribution between wages and profits.

Single product systems

Let us describe the production side of a single product system by an input-output matrix $A = (a_{ij})$, where $a_{ij}; i = 1, \dots, n; j = 1, \dots, n$, is the amount of commodity j required in industry i to produce one unit of commodity i . We choose

the total output of commodity i as the unit of measurement for commodity i .

The condition for the existence of a surplus may be expressed as:

$$\mathbf{e}'A \leq \mathbf{e}'$$

where $\mathbf{e}' = (1, 1, \dots, 1)$ is the summation vector. (For two vectors $\mathbf{a}$, $\mathbf{b}$, the sign $\mathbf{a} \leq \mathbf{b}$ means $\mathbf{a} \leq \mathbf{b}$ and $\mathbf{a} \neq \mathbf{b}$.)

The physical surplus:

$$\mathbf{l} = \mathbf{e}' - \mathbf{e}'A$$

only consists of commodities for consumption if the system under consideration is a subsistence economy. However, the surplus may also consist of commodities for investment, which allows the economic system to grow. The question now arises: According to which rule is this surplus distributed? In an economy with privately owned means of production that is governed by competitive markets, profits are paid in proportion to the advanced value of the means of production and WAGES are paid according to the amount of labour time expended. If the surplus were to consist of one single commodity (for example, wheat), then the means of production is wheat (seed), and profits and wages would be paid in wheat units. However, since the surplus as well as the means of production consist of many different commodities, the rule that profits are paid in proportion to the value of the means of production requires that the surplus must also be transformed into value terms; in order to calculate the value of the surplus, we need prices. But prices are determined by the value of the inputs (means of production) and the rate of profit on the value of these inputs plus the wage costs. Obviously, the distribution of the surplus between profits and wages has to be determined simultaneously with prices of commodities.

In a long-run condition and under competitive conditions, the rate of profit will be the same in every industry and the wage rate may also be considered to be uniform. Sraffa assumes that any difference in the quality of labour has been previously reduced to

equivalent differences in quantity (Sraffa, 1960: 10). This leads to the following system of equations:

$$(1 + r) \mathbf{A} \mathbf{p} + \mathbf{w} \boldsymbol{\ell} = \mathbf{p}$$

with the rate of profit r , $\mathbf{p}$ the price vector, $\mathbf{w}$ the wage rate and $\boldsymbol{\ell}$ the positive labour vector. Such a system is called 'basic' if all commodities can be found both among the inputs and among the outputs. Accordingly, 'non-basics' are those commodities that may be used for their reproduction (such as race-horses) but do not enter directly or indirectly into the production of any other commodity produced in the system. Non-basics play no part in the determination of the prices of the system; their role is purely passive.

his price system has two degrees of freedom; for there are n equations but $n + 2$ unknowns (n prices, the wage rate and the rate of profit). Since we only need to determine relative prices, one degree of freedom is eliminated by choosing a standard of value (which may be a monetary standard). The system may then be solved by choosing either the wage rate or the rate of profit to be exogenously determined. From a formal point of view, it is arbitrary which one is chosen. However, from a socioeconomic and historical point of view the choice is not arbitrary – which was already mentioned at the beginning of this article. For the time being, we analyse system (3) by solving for prices in terms of the wage rate, $\mathbf{p}/\mathbf{w}$. Wage-units (Keynes) or prices in terms of labour commanded (Smith, Ricardo) are often used to show how the purchasing power of wages has changed (for example, in 1970 an average worker had to work 10 minutes for a bottle of beer, but in 1990 only 8 minutes for a similar bottle). Analytically, system (3) is now transformed into:

$$(1 + r) \mathbf{A} + \boldsymbol{\ell} = \hat{\mathbf{p}}, \hat{\mathbf{p}} = \hat{\mathbf{p}}/\mathbf{w}$$

or

$$\hat{\mathbf{p}} = (\mathbf{I} - (1 + r) \mathbf{A})^{-1} \boldsymbol{\ell}$$

with $\mathbf{I}$ as identity matrix.

It is easy to see that $\hat{\mathbf{p}}$ is a non-linear function of the rate of profit. Prices in terms of commanded labour are positive for any given

rate of profit between $r = 0$ and $r = R$, where R is the maximum rate of profit. This conceptual variation of the rate of profit shows that prices in terms of the wage rate are low at a low rate of profit. Most of the surplus can be bought by employed labourers, while with a rising rate of profit prices in terms of the wage rate increase, meaning that a unit of labour time can buy less as profits rise. At the maximum rate of profit the entire surplus is obtained by the owners of the means of production. In this case prices in terms of the wage rate diverge to infinity. At a zero rate of profit, the total surplus goes to the employed labourers. Prices in terms of the wage rate are in this special case equal to labour embodied or Marxian labour values. As soon as the rate of profit rises, prices in terms of the wage differ from labour values. But one might expect that the vector of the prices in terms of the wage remains proportional to the vector of labour values; so that labour values would still be a fairly good approximation to prices in terms of the wage rate. But this is a fallacy. For the components of the price vector will in general rise with different speed. To get an intuitive understanding of this problem, we shall analyse the conditions for the opposite case first – namely, we specify the conditions for an equal speed of prices as the rate of profit rises. We consider two sectors: the first produces wheat using wheat, steel and labour as inputs; the second sector produces steel using wheat, steel and labour as inputs. According to the definition given above, this system is basic. Now, assume that the proportion of wheat input to labour and the proportion of steel input to labour is the same in both industries. Initially, suppose the rate of profit is zero, so prices in terms of the wage rate are equal to labour values. If we raise the rate of profit a little, prices will increase and the wage rate will fall. Since both commodities are outputs as well as inputs, the value of the means of production rises (rising costs of the circulating capital), while the labour costs decrease. Since both sectors display the same proportions of means of production to labour, the increase in the prices of wheat and steel leads to the same increase in the costs of

circulating capital in both sectors. Therefore, both prices (in terms of the wage rate) rise with the same speed.

In general, the proportion of means of production to labour will not be the same in both sectors and if we increase the number of sectors and commodities the assumption of equal proportions of means of production to labour in all sectors becomes even more artificial. In general, therefore, prices in terms of the wage rate will not, at a rising rate of profit, stand in any proportional relation to labour values, because relative prices (price of wheat in relation to the price of steel in our example) will undergo complex variations as the rate of profit is rising from zero to its maximum value.

Ricardo (1951–5: vol. 1, p. 46) was the first to observe that a rise in the rate of profit does not cause all prices to rise if they are expressed in terms of a commodity standard. He contrived at an invariable measure of value. This was to be a commodity produced by an industry with invariable and average proportions of means of production to labour. Sraffa found a solution for the second aspect. He proposed a standard commodity for which the causes of variations of the relative prices that we have identified would not exist. We have shown that these variations are due to a deviation of the proportion of means of production to labour from a sector considered as average. An invariable standard must reflect this. Therefore, the standard commodity must be produced by a composite industry for which the proportion of means of production to labour is the same in the industry I_0 (producing the standard itself), in the industry I_1 (producing the means of production of I_0), in the industry I_2 (producing the means of production of I_1) and so on. It can be shown (Schefold, 1989: 20–2; Kurz and Salvadori, 1995: 116–19) that the standard system producing the standard net product yields a linear wage curve and, therefore, has the same characteristics as systems with equal proportions of means of production to labour in all industries or a one-commodity world like Ricardo's corn model, in which surplus and means of production are

homogeneous. The standard commodity is as similar to the corn model as its means of production, the gross and the net product (surplus) are all homogeneous in its structure.

The standard commodity is a didactically useful exercise, because it renders transparent the relation between prices of production and distribution in single-product systems with a given technique. In joint-production systems, the existence and uniqueness of the standard commodity is intricately linked to the notion of basic commodities. It has been demonstrated (Schefold, 1989: 83 ff) that in joint-production systems the standard commodity might not exist.

Sraffa's essential goal was to show that normal prices or prices of production were defined, given the structure of production and distribution. Neither the neo-classical approach of supply and demand nor a recourse to labour values then appears to be necessary. In addition, it became obvious that prices of production could not be represented as transformed labour values. Both labour values and prices of production have a common source: the physical structure of production and the physical surplus. Thus the idea of value as the essence, and price as its appearance, turned out to be a logical fallacy and has not even a heuristic value.

Sraffa's analysis of the relation between prices and distribution also uncovered a problem of the neo-classical theory of distribution. His analysis shows that the value of capital (as produced means of production) can be measured in terms of prices. But the value of capital itself cannot be given independently of the rate of profit (Harcourt, 1972; Garegnani, 1990). This contradicts those neo-classical approaches that determine distribution by demand and supply for factors of production, with capital treated as an exogenously given value magnitude. According to the neo-classical textbook analysis, a lower or higher rate of profit in relation to the wage rate means that (respectively) more capital- or labour-intensive techniques will be used in production. Unemployment could be reduced, therefore, by lowering wages relative to profits, inducing a

substitution of capital by labour. This equilibrating mechanism is based on the assumption of an inverse monotonic relationship between capital intensity and the relative price of capital to labour, r/w . It has been proven (Garegnani, 1970) that such a monotonicity does, in general, not exist if a spectrum of techniques is considered. Sraffa's approach induced important debates on the logical validity of the foundations of the neo-classical theory of value and distribution (Harcourt, 1972) and on the logical shortcomings of the Marxian theory of labour values.

Joint production

Joint production, although highly relevant in agriculture and in industrial and even service production, has never attracted much attention in economics, whereas in business economics and business accounting it was always a relevant subject. The debates Sraffa induced had no direct relation to his findings in the theory of joint production but it is the field within which the most significant additions to the tool box of economists have been made.

According to Schefold (1989), we need to distinguish 'general joint-production systems' from 'specific joint-production systems'. In the first part of *Production of Commodities by Means of Commodities*, Sraffa assumed that each commodity was produced by a separate industry. Now, in the second part, this assumption is relaxed and it is assumed that one process may produce a bundle of commodities. In this case, there are more prices to be ascertained than there are processes. Therefore, we need more equations to determine them. Consider the simplest case: Mutton and wool are joint products of an agricultural production process (sheep-breeding). To determine the prices of wool and mutton respectively, we need a second, parallel process that will produce the two commodities by a different method and, as we may suppose, in different proportions (Process 1 produces mutton and wool (in Europe) with mutton as the main product and wool as a by-product, while in Process 2 (in Australia) wool is the main

product and mutton the by-product). But is it not highly superficial to assume that there are as many processes as there are commodities? Generally, there are more potential techniques than those actually used and, in fact, too many processes are sometimes found in reality. Therefore overdetermination, not underdetermination as perhaps expected, is the problem at hand. How is this overdeterminacy eliminated? At this stage, we have to transcend the formal method of counting equations. A little reflection shows that the competitive process tends to eliminate the overdetermination either by increasing product differentiation which increases the number of commodities to match that of processes or by eliminating supernumerary processes and the losses to which they give rise in the struggle for markets. At this stage, the arguments put forward to substantiate the assumption of an equal number of processes and commodities should be sufficient (Schefold, 1989). The price system of a general joint-production system is written:

$$(1 + r) \mathbf{A} \mathbf{p} + w \boldsymbol{\ell} = \mathbf{B} \mathbf{p}$$

where $\mathbf{B} = (b_{ij})$ and $\mathbf{A} = (a_{ij})$ are two non-negative $(n \times n)$ matrices for outputs and inputs respectively. $\boldsymbol{\ell} = (\ell_1, \dots, \ell_n)$ denotes the labour input vector, w the wage rate, r the rate of profit, and $\mathbf{p} = (p_1, \dots, p_n)$ the vector of the prices of the commodities.

Since the system must be capable of self-replacement, the most important assumption is:

$$\mathbf{e}'(\mathbf{B} - \mathbf{A}) = \mathbf{s}' \geq \mathbf{0}, \mathbf{e}' = (1, \dots, 1)$$

which means that $\mathbf{s}$, the vector of net products, must be semi-positive. The economy described by $(\mathbf{A}, \mathbf{B}, \boldsymbol{\ell})$ must have a surplus.

If one compares general joint-production systems to single-product systems, it turns out that in joint production there is a multiplicity of definitions of basic/non-basic commodities, labour values can be negative and there are peculiarities concerning the existence of the standard commodity (op. cit.).

Specific joint-production systems

Sraffa's treatment of fixed capital as a joint

product was innovative. The idea is quite simple: A production process produces jointly corn and a one-year-old tractor by means of corn, a new tractor and labour. In a second process, corn, a one-year-old tractor and labour are used as inputs to produce corn and a two-year-old tractor, and so on until period T in which the tractor wears out. We obtain the following equations:

$$(1 + r)[a_i(t)p + m_i(t-1)] + w\ell_i(t) = p_i + m_i(t); \\ t = 1, \dots, T_i$$

where a_i denotes the input vector of circulating capital in process i , p the price vector of these inputs, $m_i(t)$ the price of the tractor in period t and p_i the price of output in process i . Since we assume a finite lifetime of the tractor, we have $m_i(T_i + 1) = 0$ and $m_i(0)$ is the price of the tractor that we may take as given because the tractor is being produced elsewhere in the system.

Now, the prices of the old tractors can be eliminated by premultiplying equation t by $(1 + r)^{T_i - t}$, $t = 1, \dots, T_i$ and by adding the equations. In the special case of constant efficiency of the tractor, where $a_i(t)$ and $b_i(t)$ are the same for all t , we obtain the well-known formula for the amortization of the tractor:

$$\frac{r(1 + r)^{T_i}}{(1 + r)^{T_i} - 1} m_i(0) = r m_i(t-1) - m_i(t) - m_i(t-1)$$

Amortization consists of two parts: a financial charge and depreciation (the second term in brackets). If tractors are of constant efficiency, the amortization must be constant. The financial charge must be relatively large in the initial periods when the tractor is relatively new and therefore still valuable, and it will decrease when the tractor becomes old at later periods. It follows that depreciation must be small at the initial stages and will become larger in later periods. Depreciation is therefore progressive, in contrast to business practice which favours degressive depreciation to take account of obsolescence (being mainly due to technical progress) and, of course, to take account of taxation which we did rule out in this example.

A significant theoretical advance was the

discovery that the method to eliminate the prices of old tractors can be extended to tractors of varying efficiency. Application of this method results in a reduced system, similar to a single-product system. This reduced system allows determining prices in the same way as in single-product systems.

Up to now, it has been assumed that commodities are produced by means of commodities and labour is the only original factor of production. Now it is assumed that there are natural resources in short supply. Historically, land is the only natural resource that has been analysed in any detail in the classical theory of production and distribution. The most familiar case is extensive rent. Suppose corn is the only agricultural output. If n different qualities of land are in use, they will lead to an equal number of different methods of producing corn. At least one land is not fully utilized (marginal land), so that its price and rent are equal to zero. If corn is a basic commodity, the marginal land enters the basic system and determines (together with the other equations) the prices of the other basic commodities. Rent is then determined as difference in cost with respect to the marginal land. If profits are maximized, only those lands are cultivated that allow costs to be minimized. The combination of lands chosen may vary as the rate of profit is varied. The optimal combination of land thus changes with distribution (Kurz, 1978). It turns out that fertility of land is not a purely physical magnitude, because it cannot be defined independently of distribution. Analytically, the theory of rent can be regarded as a special case of joint production, which becomes obvious if we write the basic equations:

$$(1 + r)[a_i(t)p + m(t)] + w\ell_i(t) = p_i(t) + m(t)$$

One unit of land t at the price m is used to produce jointly one unit of commodity i and this unit of land. Subtraction of $m(t)$ on both sides gives the rent of land t ($y(t) = m(t)$) and the price of a unit of land t is equal to the capitalized rent ($m(t) = y(t)/r$). Mobility and competition ensure that rent is uniform on land of a given quality. Differential rent of the second kind or intensive rent is obtained if

more than one technique for the production of the same commodity is used on one land. The two processes (two equations) can then determine the rent and the price of the commodity simultaneously without taking recourse to no-rent land. This second type of differential rent can be used to explain the specialization of land not only in agriculture but also in urban districts and in city centres.

With *Production of Commodities by Means of Commodities*, Piero Sraffa has provided a logically coherent framework for the classical theory of value and distribution. This was the book that revived classical economics, although Sraffa himself (with his legendary cautiousness) indicated his reservations when he added the subtitle: *Prelude to a Critique of Economic Theory*. The work on the implications of the prelude is still going on.

See also:

neo-Ricardian (post-Sraffian) theory; value theory

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VOLKER CASPARI

Stabex

Since 1975, Stabex (System for the Stabilization of Export Earnings) has been an important component of successive LOMÉ CONVENTIONS between EUROPEAN UNION (EU) member-states and the AFRICAN, CARIBBEAN AND PACIFIC GROUP (ACP) countries. The aim of Stabex is to remedy 'the harmful effects of the instability of export earnings'. The system applies to the earnings from an ACP state's exports of a product covered by Stabex if, during the year preceding the year of application, earnings from the export of that product to all destinations represented at least 5 per cent of total export earnings (the 'dependency threshold'). The reference level is taken to be the average of export earnings during the previous six years (less the two years with the highest and lowest figures). Under Lomé IV, transfer payments are made to ACP countries equal to any shortfall of annual export earnings for a qualifying product below 95.5 per cent of its reference level. More generous criteria are applied to least-developed, landlocked and island states. The largest part of Stabex transfers have gone to SUB-SAHARAN AFRICA (SSA). Coffee, groundnuts, cocoa, cotton, timber and copper have been the products whose fluctuations in export earnings triggered the transfers.

Initially Stabex was welcomed by ACP countries for its simplicity of operation and rapid transfers of untied financial resources, but Lomé III and IV tightened the conditionality attached to the use of Stabex transfers and Lomé IV also restricts their use to the affected sector (broadly defined) and permits diversification only in exceptional circumstances.

Stabex transfers are only partial compensation for shortfalls already incurred and not a net addition to resources. They thus cannot be expected to have a positive effect on development.

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FREDERICK NIXSON

stabilization policies

Stabilization policies are designed to remedy major macro-economic imbalances, usually in DEVELOPING COUNTRIES or transitional economies. Such policies aim particularly at reducing INFLATION and correcting BALANCE OF PAYMENTS deficits. Stabilization is often undertaken at the behest of the INTERNATIONAL MONETARY FUND (IMF) and is likely to be associated with more general economic liberalization under STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs). While it is the IMF which is primarily responsible for overseeing stabilization, the WORLD BANK may insist that the borrower should have a stabilization programme with the IMF in place before the Bank will offer longer-term lending for structural adjustment.

Most developing countries come to structural adjustment at a time of balance-of-payments crisis, hence their need for recourse to the IMF for finance. Most stabilization programmes involve a large real devaluation and expenditure cutbacks to back up devaluation. Budget deficits and controls over interest rates are targeted, both as ways of improving the balance of payments and as part of economic liberalization.

While it is virtually certain that a country cannot successfully liberalize its economy if it does not control rapid inflation and balance-of-payments deficits, it is less certain whether

stabilization and LIBERALIZATION can proceed together. This raises *sequencing* issues. For example, liberalization could involve dismantling a restrictive trade and payments regime; this could worsen the balance of payments in the short run and increase the budget deficit if the government depends for revenue on TARIFFS on imports or on export taxes. On the other hand, a firm commitment to stabilization increases the credibility and sustainability of reform, and the World Bank appears to believe that rapid stabilization and liberalization lessens the costs of adjustment.

Stabilization programmes are controversial in many countries because of their effect on the poor. This is especially so when stabilization is achieved at the expense of economic growth, as was the case in Mexico in the mid-1980s in the aftermath of the DEBT CRISIS. The poor are affected because large devaluations raise the domestic price-level and reduce the real value of incomes, at the same time as subsidies to food and public services may be withdrawn in order to reduce the government's budget deficit.

See also:

conditionality; structural adjustment programmes (SAPs); Washington consensus

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stabilizers

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JOHN THOBURN

stabilizers

'Stabilizers' are fiscal items such as taxes and expenditures that act to counter adverse macro-economic movements by bringing aggregate demand in line with supply (see MACRO-ECONOMIC POLICY). They fall into three general categories: (1) automatic, (2) formula and (3) discretionary.

As their name suggests, 'automatic' stabilizers are those that work without prior planning. An example is progressive taxation (see TAXATION, PROGRESSIVE), where tax rates increase as incomes increase. When the economy declines, incomes of individuals (as well as of corporations) decline. With lower income, both individuals and corporations fall in lower income-tax brackets. If their tax payments decline proportionally more than their decline in income, then their spending power will not decline as much as it would have otherwise, thus stabilizing aggregate demand.

The effectiveness of an automatic stabilizer is limited. A much higher degree of strength can be achieved by introducing a 'formula' stabilizer. These are arrangements whereby changes in tax rates (and of expenditure) are legislated in advance to go into effect if and when specified changes in the economy occur.

Since economic systems are too complex to design formulas that will work in all situations, 'discretionary' stabilizers are often used. Under these, the fiscal authority has the power to change taxes and government expenditures as the situation warrants.

ROBERT LOONEY

stages of growth

The term 'stages of growth' has come to be associated with *The Stages of Economic Growth* (1960) by W.W. Rostow. In this popular book, subtitled *An Anti-Communist Manifesto*, Rostow divided the modernization process into five stages: the traditional society, the preconditions for take-off, the take-off stage, the drive to maturity, and the age of high mass-consumption. His basic claims were that (1) all societies, sooner or later, will pass through the same sequence of five economic stages, (2) the world's poor societies are simply those that have not passed beyond the first two stages, and (3) DEVELOPMENT is a process whereby traditional values are replaced by a spirit of individualism and a scientific attitude that encourages economic growth and technological progress.

From the outset, Rostow's theory, otherwise known as a key contribution to MODERNIZATION THEORY, came under relentless attack. A major criticism was that Rostow's theory failed to recognize that DEVELOPING COUNTRIES are surrounded by a quite different international economic system than the system that surrounded the advanced countries at the time when they began to develop. As proponents of DEPENDENCY THEORY indicated, the economic positions of the developed and underdeveloped countries of the world are linked historically and cannot be understood in isolation from one another: to begin with, it was colonization that caused the prosperity of the high-income countries at the expense of countries in Latin America, Africa and Asia.

Many scholars, however, have come to recognize the analytical value of the phrase 'take-off into sustained growth' (see TAKE-OFF THEORY), as the term that has become synonymous with 'industrial revolution' in the textbooks. The phrase says that growth will be 'sustained' once the rate of investment rises from around 5 per cent of the national income to 10 per cent. Environmentalists, on the other hand, contend that the very idea of 'stages of economic growth' is an ethnocentric imposition of Western values on other cultures

around the world. This notion of 'stages of growth' encourages a materialistic, competitive way of living, including the idea that nature is an infinitely exploitable 'resource'. This ecological opposition to growth also includes indigenous communities who are attempting to preserve tropical rainforests from extensive timber-cutting and conversion to pasture for beef cattle.

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RICARDO DUCHESNE

stagflation

Prior to 1958, most economists and lay-people believed that there was a direct relationship

between price level changes and output growth, so that the price level generally increased when demand for products was growing faster than the economy could supply them. INFLATION was often characterized as being caused by too much money chasing too few goods. In 1958, however, the price level in the United States rose significantly, while at the same time employment and gross domestic output fell. These facts did not match the conventional wisdom regarding inflation.

This 1958 experience, therefore, stood in sharp contrast to the rest of the historical record and, in the 1960s, was thought to be a historical anomaly. In the 1970s, however, rapidly rising prices became closely associated with sharp increases in unemployment and with significant decline in the output of goods and services produced. In such a situation, it is clear that the inflation being experienced could not be caused by too much money chasing too few goods, since the demand for goods and services declined while the price level increased by 12 per cent, and unemployment increased from 5 to 9 per cent while the real output of the economy fell by approximately 5 per cent. The United States was experiencing a simultaneous occurrence of rapid inflation and economic stagnation. A new term was created to describe this phenomenon where high unemployment and high inflation appeared simultaneously: 'stagflation'. Again in the recession of 1980, there was a resurgent increase in both inflation and unemployment.

The 1958 stagflation period was associated with rising money-wage rates increasing more rapidly than growth in labour productivity, even as demand stagnated. The lesson learned from the experience encouraged the Kennedy administration to institute voluntary wage-price guidelines. Under the guidelines, the president requested that the major unions hold their annual money-wage increase demand to 3.2 per cent, the historical rate of labour productivity increase since World War II. As long as money-wage increases were so constrained, it was argued, unit labour costs of production should be unchanged and hence firms could hold the line on prices and still

stakeholder economy

make profits by increasing output as demand increased. These wage-price guidelines were a mild form of 'incomes policy' – a type of policy where government attempts to constrain the inflationary income-demands of the owners of resources that go into the production of goods and services.

The Kennedy–Johnson administration attempted to stimulate the economy through a variety of fiscal policies, including tax cuts, government-spending increases and a monetary policy that encouraged low INTEREST RATES. The result was a rapid decrease in the unemployment rate without significantly increasing prices. Between 1961 and 1967, the unemployment rate fell from 6.7 to 3.8 per cent, while the inflation rate increased moderately from 1.6 to 2.6 per cent and total real output increased by 22 per cent over the six year period.

The stagflation of the 1970s and 1980s, however, was associated with worldwide commodity price inflation, especially sharp increases in the price of crude oil caused by the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) cartel, and then fuelled by cost-of-living adjustments in many union contracts that automatically forced money-wage increases that exceeded labour productivity increases. To fight inflation, many countries attempted to adopt some form of incomes policy. The most limiting of these incomes policies was the wage and price controls policy introduced in the United States on August 1971. This was gradually replaced by more voluntary constraints under a government-sponsored Council of Wages and Price Stability. By the end of the decade, all such constraints had been ended except on petroleum products. The latter were removed by one of the first acts passed by President Reagan in 1981.

Many other incomes policy schemes beside direct controls of wages and prices or even voluntary compliance with government wage-price guidelines were suggested by economists during the period of the 1970s. One of the most well-known plans was a tax-based incomes policy (TIP) suggested by Professor Sidney Weintraub of the University of Pennsylvania and Dr Henry Wallich of the Federal Reserve

Board. TIP involved legal disincentives through higher taxes levied directly against those who fostered demands for higher money incomes.

PAUL DAVIDSON

stakeholder economy

The 'stakeholder economy' has become a key concept for those, predominantly on the left of the political spectrum, seeking to identify an alternative political economy to that articulated by the New Right since the late 1970s.

The stakeholder economy is one in which the institutions which exist between the individual and the state voluntarily operate in a manner that both acknowledges and redresses the costs imposed on society by the pursuit of individual self-interest in general and the assertion of individual property rights in particular. These costs (notably the resulting inequalities in the distribution of income, opportunity and risk) are held to place certain obligations on the owners of private property.

The stakeholder economy is built on the six key propositions that define stakeholding itself:

1 A rejection of:

the view that the individualistic neo-classical model can result in either private property holders exercising obligations commensurate to their 'rights' or in an appropriate distribution of risks and income.

(Hutton, 1997: 7)

- 2 The need to increase the demand for labour in order to reduce the incidence of job insecurity, underemployment and very low wages for the unskilled.
- 3 The need in a market economy to create democratic institutions that generate social capital, particularly TRUST.
- 4 The belief that businesses operate most effectively on the basis of internal commitment, certainty and trust.
- 5 In the individualistic contracting environ-

ment of the market, intermediate institutions are able to create social capital and deliver the long-term perspective to foster an investment culture.

- 6 The need for systems of social insurance and distribution of risk which must be fair and inclusive.
(ibid.: 8)

Although for many on the left, stakeholding has provided an attractive political design to fill the ideological vacuum arising from the collapse of COMMUNISM and the discrediting by the New Right of previous social democratic and Keynesian agendas (see SOCIAL DEMOCRACY; KEYNESIAN ECONOMICS), the problem with the notion of the stakeholder economy is that it is rather indeterminate and vague until translated into detailed proposals. Once translated, these proposals entail a process of radical social, political, economic and constitutional change for those societies, such as the United Kingdom, which are regarded as being in need of urgent remedial surgery. The stakeholder economy has therefore been attacked by the right for not clarifying how this radical agenda is to be implemented or how the vested interests of private property owners are to be reconciled with their new obligations and responsibilities to society.

See also:

Hutton, Will; neo-classical economics

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SIMON LEE

Stalinism

'Stalinism' refers to the system of government in the Soviet Union that existed from 1929 to 1953 under the leadership of Joseph Stalin (1879–1953). Stalinism was largely based on Marxist tenets (see MARXISM–LENINISM), although in some cases it was significantly altered to suit Stalin's purposes. The most notable characteristic of Stalinism is the absolute POWER that Stalin wielded over Soviet SOCIETY. Stalin exercised this power through his control of the Communist Party (CPSU) and justified his actions under the policy of the 'dictatorship of the proletariat'. Stalinism promulgated the 'revolution from above', which resulted in the collectivization of Soviet agriculture and the implementation of heavy industrialization programmes. Stalinism entailed the building of SOCIALISM IN ONE COUNTRY, rather than the international promotion of SOCIALISM.

See also:

communism; Marxism–Leninism

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J. ANDREW GRANT

standard international trade classification (SITC)

The standard international trade classification (SITC) is the numerical coding system

state socialism

established by the UNITED NATIONS (UN) for classifying COMMODITIES used in international trade.

The SITC was first issued by the UN in 1950 and has had three revisions since then. Its main purpose is to promote international comparability of trade statistics. The hierarchical structure of SITC consists of Sections (10), Divisions (67), Groups (261), Subgroups (1,033) and Items (3,121), thus leading to a five-digit code. The higher the number of digits of an item the more precisely it is defined by the system. Due to harmonization activities, SITC shows particular correspondence with Central Product Classification (CPC) – for example, all of its five-digit codes are equal to a single subclass of CPC. There is also considerable correspondence with the Harmonized Commodity Description and Coding System (HS) and International Standard Industrial Classification of All Economic Activities (ISIC).

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PETER KÜHNEL

STAR WARS see Strategic Defense Initiative (SDI)

state socialism

In the history of socialist thought, the term 'state socialism' represents an idea – a doctrine – as well as an IDEOLOGY of development. As an idea, it is one of a variety within a broader body of socialist thought in the nineteenth century. Thus seen, state socialism represents a range of socialist ideas that emphasizes, among other things: state financing but worker control of factories; state control and regulation of markets and prices; the improvement of work-

ing conditions, and the restoration of community bonds and values. Central to all these, is the idea that the STATE is the only body capable of building a socialist order. As a doctrine and ideology, the term's twentieth-century usage came to denote state control and direction of economic, political and social life by a single-party state. There thus appears to be a kind of continuity between the term's early nineteenth-century usage and its application in the twentieth century, particularly in the emphasis on the state's role in building SOCIALISM. It is in the latter sense, as doctrine and ideology, that the term came to play a significant role within Marxist political theory and in international relations (IR).

State socialism developed during the early to mid-nineteenth century, in response to the social dislocations caused by the development of CAPITALISM. Such problems include mass poverty, poor working conditions and the atomization of society. It was an attempt to explain the impact of capitalism, as well as a vision for a new society. The vision includes the improvement of the conditions of the working class (see CLASS, WORKING), tackling urban mass poverty, replacing the individualism of capitalism with cooperation, and stopping the chaos of the market. These were held as the routes to building a socialist society. Differences, however, exist in the explanations advanced for the dislocations caused by capitalism, in the nature of the vision for a new society and in how to translate that vision into reality.

Some, like ROBERT OWEN (1771-1858), advocated a new society free of competition in which cooperation and communitarian ideals would replace the individualistic spirit and profit motive of capitalism. Towards this, Owen envisioned 'villages of cooperation' where work would be organized on a cooperative rather than a competitive and selfish basis, and he regarded this as an important step towards a new and just social order. Others, like Louis Blanc (1811-82), argued for the creation of worker-controlled 'social workshops.' Such workshops would guarantee employment and forge cooperation among

humans. Identifying competition as a key element in stunting the development of personality, cooperation was posed as the solution to capitalist selfishness and individualism. He suggested the establishment of state-financed but worker-controlled factories, a measure he hoped would gradually usher in a socialist society. On the whole, though, state socialism came to represent both an analysis of capitalism and a vision of socialist society. In this sense, it emphasizes state ownership and financing of factories on behalf of workers; the nationalization of the economy; state regulation of the market; the imposition of price controls, and the improvement of the conditions of the working class. Finally, the responsibility for building socialism is reposed in the state. These, then, are the essential elements contained in the idea of state socialism and its vision of a new socialist society.

MARX and Engels scathingly criticized these ideas as utopian and idealist. In their radical reworking of socialist theory, both rejected the idea of the state as the prime force in the construction of socialism. Terming this position idealist, both attacked the proponents of state socialism for their reformism and naivety. The goal of socialism for which they argued is not merely to improve the condition of workers. It is rather the revolutionary transformation of the whole society and the smashing of the bourgeois state by the working class. This transformation is the historic role of the proletariat and not of some idealized state. They equally rejected the reformist implications of state socialism as the gradual redistribution of resources through cooperative workshops. Instead, the seizure of power from the ruling by the working class is posed as the basis for the creation of a new society, free of EXPLOITATION and class domination. CLASS STRUGGLE, rather than the state, is the basis for creating this new society. In essence, Marx and Engels mounted a critique of capitalism, identified its general laws of motion and development, and gave the working class a clear historical role in the construction of socialism. In this radical recasting of socialist theory, the material conception of history that

places the production of social life at the centre of analysis and the emphasis on class struggle as the driving force in the historical development of society are clearly the most significant distinguishing characteristics demarcating their approach from state socialism and from other forms of socialist thought.

In the twentieth century, the establishment of the first socialist state in Russia in 1917 continued, though in a different format, the debate between state socialism and Marxism (see MARXISM—LENINISM). This debate became a little bit more complicated due to some 'utopian' elements in Marxism itself. Nevertheless, the debate focuses on the role of the state in the construction of socialism. Since, in classical Marxism, a socialist revolution is predicated on the development and 'maturity' of capitalism, and since it entails smashing the bourgeois state, two interrelated questions arose for the Russian revolutionaries: how to address the industrial backwardness of Russia and whether or not to do it through the old Tsarist state. For MENSHEVIKS, both questions were answered through recourse to the classical literature. Noting the weakness of the working class in Russia and believing socialism to be the end result of mature capitalism, they argued for an evolutionary road to socialism. The task meanwhile is to support capitalists in smashing the remnants of the aristocracy. BOLSHEVIKS on the contrary pressed for smashing the old state and building socialism immediately. The weakness of the Russian bourgeoisie was seen as an opportunity for the proletariat to seize state power. The proletariat's task was to smash the old state and establish a new socialist society, the first of a series of steps towards communism. This was the Bolshevik notion of the 'permanent revolution'. The Bolsheviks, of course, won the struggle.

The tasks of the new socialist state, as well as its ideological role, made it increasingly dominant in Soviet society. The idea of the 'dictatorship of the proletariat' meant the socialization of society's resources, ending the exploitation of person by person, defending the revolution from both internal and external enemies, and industrializing the society. This, in turn, meant

state, the

a dominant state role and such dominance began to resemble some strands of the nineteenth-century state socialism that Marx and Engels so heavily criticized. The state became even more dominant after Lenin's death in 1924. With Stalin in power, state centralization and administrative control of Soviet society was tremendously expanded. His idea of SOCIALISM IN ONE COUNTRY, in opposition to Trotsky's idea of PERMANENT REVOLUTION, came to underscore and justify collectivization, state-directed and centralized planning, a huge and dominant party bureaucracy, as well as TOTALITARIANISM. Through these, a regime of terror that revolved around the party and a 'cult of personality' became the most visible features of state socialism. Although the state claimed to have abolished classes through the socialization of resources and the provision of social welfare, class divisions expanded and the gap between the state-party apparatus and the proletariat kept widening.

State socialism as practised in the Soviet Union has had tremendous impact on the development of both socialist theory and socialist states. This system was imposed on a large part of Eastern and Central Europe after World War II, and this had greatly influenced world politics in the ideological war between socialism and capitalism until late 1989 (see COLD WAR). It is not only in Eastern Europe, however, that the idea of socialism as a state-directed doctrine and ideology of development made an impact. In Africa and Latin America too, socialist countries in one way or another adopted a variation of the Soviet model for a number of reasons. Many of these countries saw in the former Soviet Union and its model the possibility of addressing their condition of economic backwardness and continued peripheralization in the world economy (see CORE-PERIPHERY MODEL). The Soviet model became one of a number of ideologies of resistance against IMPERIALISM, a path to quick industrialization and a tool for the unification of diverse nationalities. Moreover, the significance of the peasantry as a revolutionary force and its role in the social transformation of Soviet society was a lesson that left its mark on many

revolutionary movements in developing societies. The implication of all this is that socialism came to be increasingly seen in terms of the dominant role of the state as a prime force in transforming peasant societies into industrial societies, and as the vehicle for social change.

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MOHAMMAD J. KUNA

state, the

As the principal political institution which shapes and has shaped the nature and operation of both the national and the international market, the state is central to the study of POLITICAL ECONOMY. The state embraces both a historical reality, whose institutions have stood in a complex relation with not only the market but also wider society, and a philosophical idea, the various definitions of which have assumed a particular relationship between politics and economics. However, the very significance of the state in the process of economic development has meant that its nature and role in that process has been essentially contested by the principal ideologies of political economy (namely, REALISM, LIBERALISM and Marxism – see MARXISM–LENINISM).

As Andrew Vincent has noted, one of the most intractable problems concerning debates about the nature of the state has been the fact that there has been little agreement about what is being studied or indeed what should be

studied (Vincent, 1992: 43). Furthermore, it has been argued that the nature and role of the state can only be understood if attention is paid to the international context in which domestic political economy is located because, given that

states are intrinsically Janus-faced, standing at the intersections of transnational and domestic processes, their structures, capacities, and policies are always influenced by identifiable aspects of the particular world historical circumstances in which they exist. (Evans, Rueschemeyer and Skocpol, 1985: 350)

David Held has noted that:

the idea of the state is often linked to the notion of an impersonal and privileged legal or constitutional order with the capability of administering and controlling a given territory.

(Held, 1983: 1)

Thus, for example, the WORLD BANK has recently defined the state as:

a set of institutions that possess the means of legitimate coercion, exercised over a defined territory and its population, referred to as society. The state monopolizes rulemaking within its territory through the medium of an organized government.

(World Bank, 1997: 2)

This liberal democratic tradition has understood the role of the state in terms of an institution whose legitimacy is derived from its accountability to the population being governed through a system of representative democracy. The democratic state has enjoyed sovereignty over the territory it controls, but it in turn has been subject to the popular sovereignty of an electorate whose general or public interest the state has been charged with articulating and defending.

Because of its emphasis on the individual and the individual's capacity to maximize their freedom and welfare in open markets, liberalism as an ideology of political economy has traditionally identified a more limited role for the state than either Marxism or realism. However, the very longevity of liberalism as

an IDEOLOGY has meant that the conception of the state deployed by liberal political economy has changed markedly since the classical economics of ADAM SMITH and DAVID RICARDO. Despite his association with the INVISIBLE HAND of the market as the root cause of the wealth of nations, Adam Smith was nevertheless prepared to sanction a role for the visible hand of the state in the public provision of defence, administration and justice, and of certain institutions and works (notably physical infrastructure and public education). However, Smith's limited role for the state is very different to that of another great thinker in the tradition of liberal political economy, namely JOHN MAYNARD KEYNES, who identified a much more extensive role for the state in the achievement of full employment. The transition from Smith to Keynes is indicative of how the different ideologies of political economy have been able to accommodate differing and constantly evolving conceptions of the state.

The liberal democratic notion of the state, with its central underlying assumption that the state represents the general or public interest, has been contested by Marxist conceptions of the state which have regarded the state as a powerful instrument of political action and societal control on behalf of the interests of the dominant class. In defending private property, the state is held by Marxists to be neither neutral nor the representative of the public interest, but rather the coordinator of a divided society in the interests of the ruling class. Although the state enjoys a degree of autonomy in its operation and manipulation of civil society, it is ultimately dependent on and the instrument of those who own and control the productive process. The state is therefore the 'superstructure' which develops the 'foundation' of economic and social relations (Held, 1983: 28). The autonomy which the state enjoys is merely that which is exercised to settle disputes between different elements of capital – for example, between industrial and finance capital or domestic and international capital.

Marxist theories of the state have been criticized for possessing

deeply embedded society-centred assumptions, not allowing themselves to doubt that, at base, states are inherently shaped by classes or class struggles and function to preserve and expand modes of production.

(Skocpol, 1985: 5)

The possibility of the existence of many forms of autonomous state action which are not merely reflective of the interests of particular classes or groups within society has therefore been excluded by many Marxists for generations. To counter this tendency and 'to bring the state back in' to the social sciences, not least political economy, Skocpol has advocated two alternative but complementary analytical strategies. First, states should be viewed as

organizations through which official collectivities may pursue distinctive goals, realizing them more or less effectively given the available state resources in relation to social settings.

(ibid.: 28)

Second, states should be viewed

more macroscopically as configurations of organizations and action that influence the meanings and methods of politics for all groups and classes in society.

(op. cit.)

Among the principal ideologies of political economy, it is the realist school of political economy which has accorded the state the most central role in its understanding of the relationship between politics and economics, and the state and the market. Like its antecedents, MERCANTILISM and ECONOMIC NATIONALISM, realism has regarded NATION-STATES as the most important actors in international political economy. Asserting the primacy of politics over economics and the separation of the domestic and international spheres of political economy, realism has portrayed nation-states as rational actors able to determine the best course of action to maximize their power in an anarchical international society. This conception of the state has been widely criticized, not least because of its underestimation of the political

and strategic importance of economics and economic policy issues for national power. At the same time, realism's state-centric perspective on political economy has been criticized both for ignoring the importance of non-state actors (not least MULTINATIONAL CORPORATIONS (MNCs) and other major market actors) in the contemporary world economy and for exaggerating the degree to which the state and its institutions can be understood as a unified, rational actor able to determine the national interest without serious political conflict.

The idea of a central role for the state in the process of economic DEVELOPMENT has been particularly important for those relatively economically backward, late-industrializing economies that have sought to catch up with their more developed and industrialized competitors by rapidly mobilizing their own national economic power. During the nineteenth century, this developmental conception of the role of the state was pioneered in the national political economy of FRIEDRICH LIST who advocated a proactive role for the state in the development of a nation's productive powers. More recently, economic nationalism as a basis for the political economy of the state has been highly influential among the economies of East Asia, where rapid post-war industrialization was facilitated by the primacy given to economic growth by the institutions and interventions of a strong DEVELOPMENTAL STATE. The relative economic success of this particular state-form has been largely attributed to the advantages of societies characterized by an equitable distribution of wealth and a well-educated population, and the presence at the heart of the state of a highly determined technocratic elite able to consciously plan and deliver market-conforming interventions by virtue of its control over the allocation of credit, its insulation from the demands of vested interests and its preparedness (where deemed necessary) to suppress civil rights in the interests of national economic development.

During the post-war period, the expansion of this bureaucracy in many Western industrialized economies was driven by the widening role of the state in the provision of basic social

welfare – that is, the delivery of free education and health services. The widespread adoption of Keynesian economic policies (see **KEYNESIAN ECONOMICS**) in the management of both domestic economies and the international economy under the **BRETTON WOODS SYSTEM** further extended the role of the state in the provision of full employment. The phenomenon of increased state ownership, regulation and intervention remained largely unquestioned until the late 1960s and early 1970s when, following a period of faltering economic growth and rising unemployment (not least because of the effects of the oil crisis of 1973–4), the Keynesian **WELFARE STATE** consensus came under an ideological assault, especially in the United Kingdom and the United States, from a group of politicians and economists latterly known as the ‘New Right’.

Drawing on a fusion of liberalism and conservatism, the New Right has advocated a much reduced role for the state, based on a belief in the inherent superiority of the market both as an allocator of scarce resources and, more importantly, as a source of individual freedom, especially for the expression of entrepreneurial initiative and innovation. This agenda has been based on the twin contentions that the post-war social democratic Keynesian welfare state consensus had not only overloaded government, undermined the authority of the state and rendered society ungovernable, but had also, through its use of Keynesian economics, created the false expectation that governments could deliver full employment and low inflation when in practice they could not (King, 1987: 63–5).

As an alternative to the post-war social democratic Keynesian welfare state, the New Right has advocated policies of **PRIVATIZATION**, **LIBERALIZATION** and **DEREGULATION** in an attempt to ‘roll back’ the frontiers of state intervention and government spending. This conception of the political economy of the state has been understood in terms of thesis and antithesis. The thesis, the integrating force in society which the New Right wished to restore, was society’s purported natural tendency to order and the economy’s inherent tendency to

growth wherever entrepreneurs had been given the freedom to innovate by open markets. The antithesis, which the New Right wished to dismantle, was the politicized dependency culture of the post-war social democratic Keynesian welfare state, where excessive state intervention and producer-group power had displaced the entrepreneur and open markets as the prime agencies of social change (Bosanquet, 1983: 8–23).

Despite the widespread adoption of New Right policies by political parties elected to office in major industrialized economies, not least the United Kingdom and the United States, there is little evidence to suggest that the New Right’s ideological and rhetorical emphasis on a more limited role for the state has actually delivered significantly lower government spending. The collapse of **COMMUNISM**, and with it the demise of the communist totalitarian state, provided the highwater mark of New Right triumphalism. More recent electoral defeats and the apparent resurgence of social democratic government have triggered a vigorous debate within the New Right about the nature of the state that will be the political and economic inheritance from the twentieth century. From the libertarian wing of the New Right, the way forward has been cast in terms of the ‘liquidation’ of the state over a period of decades (Duncan and Hobson, 1994). From the more conservative wing, the notion of civic conservatism, in which the state plays an active role in fostering strong civic and local self-governing institutions in an open market economy, has been advanced (Willetts, 1992). However, thus far neither vision has been translated into a successful programme for government. Indeed, some have suggested that the damaging effect of the New Right’s policies on the social cohesion of previously settled communities now demands a different and more proactive, rather than diminished, role for the state (Hutton, 1995).

Among the most important and influential conceptions of the appropriate role of the state in economic development are those held by the major institutions responsible for the governance of the world economy. For example,

during the 1990s, the WORLD BANK has consistently emphasized the importance of the role of the state being limited to 'market-friendly intervention'. For state intervention to be 'market-friendly', the Bank has contended that intervention should be reluctant and primarily limited to the provision of those public goods not readily supplied by the market; subject to checks and balances, through the continual exposure of interventions to the discipline of the international and domestic markets; and open, through simple and transparent interventions 'subject to rules rather than official discretion' (World Bank, 1991: 5).

A major challenge was presented to this neo-classical conception of the state by the phenomenon of the more proactive role played by DEVELOPMENTAL STATES in East Asia's rapid post-war industrialization. This challenge became particularly acute when the World Bank was pressured by the Japanese government into undertaking an in-depth study of the 'East Asian Miracle'. The Japanese hoped that the study would identify an alternative 'developmental' political economy of the state to the more limited conception held by NEO-CLASSICAL ECONOMICS. The dilemma posed for the Bank by this exercise was that if its report indicated that a proactive role for the state had been a necessary condition of rapid development, the conclusion would contradict the basis of its previous policies. By retaining management control over the final report, the Bank was able to fudge the key issue of the role of the state by suggesting that the Asian economies' strong growth performance was due to a 'a market-friendly approach' and 'getting the basics right', while simultaneously acknowledging that:

In most of these economies, in one form or another, the government intervened – systematically and through multiple channels – to foster development, and in some cases the development of specific industries.

(World Bank, 1993: 5)

The Bank discounted the developmental state's challenge to the neo-classical orthodoxy by concluding that 'industrial policies were largely

ineffective' and 'generally not successful', despite the fact that it had previously acknowledged that just such a definitive conclusion about the state's role would be difficult: 'Because we cannot know what would have happened in the absence of a specific policy' (ibid.: 312, 354).

More recently, the World Bank has sought to redefine its conception of the state in the light of the collapse of communism, the important role for the state in the East Asian high-performing economies, the collapse of states and increase in humanitarian emergencies, and what the Bank portrays as the widespread fiscal crisis of the state in industrialized economies. The Bank's central contention now is that 'the state is central to economic and social development, not as a direct provider of growth but as a partner, catalyst, and facilitator'. For the state to play an effective role in a country's development, the Bank has advocated that the state's capability (that is, its ability to undertake and promote collective actions efficiently) must be increased. However, the first element of the Bank's strategy to fulfil this objective is that the state's role must be matched to its capability, which translates into a 'sharper focus on the fundamentals'. The second element of the strategy is the raising of the state's capability by the reinvigoration of public institutions. This translates into the Bank's advocacy of more effective rules and restraints to counter arbitrary state actions and corruption, greater competition to improve the efficiency of state institutions, and wider participation and decentralization to bring government closer to the people (World Bank, 1997: 3).

The World Bank's assertion that 'markets and governments are complementary: the state is essential for putting in place the appropriate institutional foundation for markets' (ibid.: 4) might appear to constitute a departure from its previous neo-classical conception of the role of the state. There appears to be an implicit suggestion of a more active role for government. In practice, the Bank is merely reinforcing its earlier stance by seeking to define a

more limited politics in which the state's role is confined to addressing the needs of entrepreneurs and firms, and increasing their returns from private investment. The needs of other groups in society, not least the poor or socially excluded, is marginalized by the Bank's conception of the state. One of the many other problems with the World Bank's 'sharper focus on the fundamentals' is that such a focus did not prevent the Asian financial crisis (see ASIAN CRISIS) spreading among a group of previously high-performing Asian economies which the World Bank itself had previously acknowledged to have got the fundamentals right (World Bank, 1993: 5).

During the 1990s, in the wake of the collapse of communism, one of the central debates in international political economy has concerned the challenge posed to the role of the state by the GLOBALIZATION of markets. For example, Kenichi Ohmae has asserted that in an increasingly borderless WORLD ECONOMY, 'nation states have become little more than bit actors'. Indeed, the very notion of the nation-state has become 'increasingly a nostalgic fiction', because goods and services are now produced by companies whose brands have little more than symbolic attachment to the nation-state (Ohmae, 1995: 12–13). In this borderless world, the natural economic zones are regional states (for example, Silicon Valley, Baden-Württemberg, northern Italy), rather than national economies. This transformation has been brought about by 'rapid cross-border migration of the four I's' – namely investment, industry, information technology and individual consumers (ibid.: 142). Region-states are held to have been more successful than their larger national predecessors in providing effective ports of entry to the global economy for both individual entrepreneurs and large MULTINATIONAL CORPORATIONS (MNCs).

The assault on the nation-state advanced by Ohmae and other proponents of globalization has been severely criticized by Paul Hirst and Graham Thompson. Their work has sought to demonstrate that, far from being an ineluctable and irreversible trend which has fatally undermined the role of the state in economic

development, globalization is largely a myth. Hirst and Thompson have contended that the contemporary highly internationalized economy is nothing new, since the international economy was arguably more open and integrated during the period 1870–1914. At the same time, there appear to be relatively few genuinely multinational corporations, while the mobility of capital has yet to produce a huge shift in investment from the advanced to the developing economies. Given that trade, investment and finance is not genuinely 'global', but largely concentrated in Europe, North America and Japan, these major economic powers therefore continue to possess the state capacity to coordinate economic policy and to deliver effective governance of financial markets (Hirst and Thompson, 1996: 2–3).

From this analysis of the contemporary world economy, Hirst and Thompson have suggested that the nation-state continues to have 'a significant role to play in economic governance at the level of both national and international processes'. However, this pattern of governance will require states 'to function less as "sovereign" entities and more as components of an international "polity"', thereby providing legitimacy for and accountability of both supranational and subnational governance structures (ibid.: 170–1). Despite this pooling and fragmenting of the state's national economic sovereignty, Hirst and Thompson have contended that the nation-state will continue to retain the key role of regulation of populations by virtue of its possession of a large measure of territorial control, not least because of its status as the primary source of the rule of law.

Linda Weiss has provided a further important counter-argument to the thesis that the state is increasingly impotent in the face of the globalization, asserting that the contemporary global economy is one where 'the nation state retains its importance as a political and economic actor' (Weiss, 1998: 212). This is because, in her judgement, the nature and impact of globalization has been greatly exaggerated. Apart from the partial exception of certain globalized financial markets, the

global economy is characterized by weak globalization and strong internationalization: instead of there being a uniform national response to globalization, producing convergence towards a single neo-liberal model (see NEO-LIBERALISM), international markets are subject to a great diversity of state responses. As a consequence, the emphasis is not on impotence, but rather the adaptability and differentiation of state power. Indeed, Weiss has concluded that:

we can expect to see more and more of a different kind of state taking shape in the world arena, one that is reconstituting its power at the centre of alliances formed either within or outside the nation-state. For these states, building up or augmenting state capacity rather than discarding it would seem to be the lesson of dynamic integration

(ibid.: 212)

Those who have studied the nature of the state in order 'to bring it back in' to the social sciences have concluded that 'little is to be gained from more grand theorizing about the state in general' for 'critique and prescription have tended to overshadow and constrain analysis' (Evans, Rueschemeyer and Skocpol, 1985: 364–5). Therefore, it has been suggested that rather than pursuing an overly normative and prescriptive approach to the study of the state, which glorifies state power by over-estimating its efficacy, it would be more fruitful to pursue a better understanding of the roots and causes of state actions and capacities.

See also:

East Asian model: ideologies of political economy

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SIMON LEE

state theory

Since the seventeenth century when the term was first widely deployed, the concept of the STATE has been heavily contested. It remains so today. Yet whether depicted as an overbearing apparatus of patriarchal oppression or as the very condition of social and political freedom, as an 'ideal collective capitalist' or a fetter on the self-regulating capacity of the market, few

commentators would disagree that the concept of the state is fundamental to social, political and economic analysis. The state, for better or worse, mobilizes populations in defence of its realm; regulates, monitors and polices conduct within CIVIL SOCIETY; intervenes (more or less intensively) within the economy, and regulates (and, in some instances, controls) the flow of information within the public sphere, to detail merely some of its more obvious activities. Few, then, would deny the ubiquity or pervasiveness of the influence of the state within modern societies. Or so we might imagine. Yet if the concept of the state is essentially contested, in recent years its very relevance has come under increasing dispute. In an era of GLOBALIZATION and of complex INTERDEPENDENCE among nations, it is often argued that the influence of the NATION-STATE is waning, its very form and function under challenge.

In this essay we examine the emergence and development of the distinctive concept of the modern state in European political thought. We then examine the two principal approaches to the study of the modern state – Marxist and Weberian – and their evolution, before considering the contemporary challenge to the ascendancy of such theoretical traditions presented by Foucauldian, discourse-analytical and, above all, feminist perspectives (see NEO-MARXISM; NEO-WEBERIAN APPROACHES; FEMINISM). We conclude by considering the prospects for the state and for the theory of the state in an era of supposed globalization.

The genealogy of the modern state

Etymologically, the notion of the state is derived from the Latin *status*, meaning literally social status, stature or standing, specifically of an individual within a community. By the fourteenth century, the use of the term to refer to the standing or status (indeed to the 'stateliness') of rulers, distinguishing and setting them apart from those subject to their rule, was commonplace. In the idea that the state resides in the body of the ruler, indeed that the state and the 'sovereign' are synonymous, this

was a characteristically pre-modern formulation.

The development of a distinctively modern conception of the state would take a further three centuries. A first step was taken by the authors of the so-called 'mirror-for-princes' writings, most famously Machiavelli in *The Prince* (1513). In this literature, the state (*lo stato*) now became synonymous not only with the prince, but with the character of the political regime, the geographical area over which sovereign authority was claimed and maintained, and the very institutions of government required to preserve such authority.

A second development came with the republican political theory of the Renaissance. This movement championed the cause of a self-governing republican regime which might inaugurate a 'state' or condition of civic liberty – in Dante's terms *lo stato franco*. Here, at last, we see the emergence of a conception of an autonomous civil and political authority regulating the public affairs of an independent community or 'commonwealth'. The state is here presented as claiming and enjoying a monopoly over the legitimate use of violence and as deriving the authority for this claim not from the power or stature of its ruler(s), but from the people themselves. The state is referred to for the first time as a distinct apparatus of government which rulers have a duty to maintain and which will outlast their rule, as opposed to an extension of the latter's innate authority.

The final step came with the rise of the absolutist state in Europe in the seventeenth century. Here, in particular in the writings of Jean Bodin and THOMAS HOBBS, the state is eventually conceptualized as truly separate from the powers of the ruler and the ruled. Three aspects of this formulation set it apart as a distinctively modern conception of the state: (1) individuals within society are presented as subjects of the state, owing duties and their allegiance not to the person of a ruler but to the state itself; (2) the authority of the state is singular and absolute, and (3) the state is regarded as the highest form of authority in all matters of civil government (Skinner, 1989: 90).

Hobbes' *Leviathan* (1651) – and the rise of the absolutist state which this work reflects – marks the end of the pre-modern conception of the state in which political power is understood in personal and charismatic terms. The state now comes to be seen as a distinct form of authority independent of those who give effect to its power.

Weberian and neo-Weberian approaches

It is this modern conception of the state that has tended to concern political theorists of the nineteenth and twentieth centuries. Indeed, that definition of the state most often accorded the status of *the* definition the state – the Weberian one – displays considerable similarities to Hobbes' understanding of the state. MAX WEBER, as is often noted, defined the state not in terms of its function but in terms of its means, more specifically in terms of its organization and deployment of the means of coercion and physical force.

A compulsory political organization with continuous operations will be called a 'state' insofar as its administrative staff successfully upholds the claim to the monopoly of the legitimate use of physical force in the enforcement of its order.

(Weber, 1978: 54)

Two aspects of this definition are particularly noteworthy, providing as they do the basis for much contemporary reflection on the state. First, the state for Weber is a set of institutions with a dedicated personnel. This observation has been taken up and developed by a diverse group of neo-Weberians, neo-statists and historical institutionalists working in particular in the United States. They argue that the differentiation of the state from CIVIL SOCIETY allows state managers to develop an array of distinct interests, preferences and capacities which cannot be explained by reference merely to societal factors. In their efforts to 'bring the state back in' as both an actor and an independent force in social causation, the neo-statists have emphasized both the autonomy of the state from society and the power of

'state-centred' explanations of political outcomes. More specifically, they have concentrated on: the ability of state managers to exercise power independently and autonomously of non-state forces; the 'infrastructural power' of the state to infiltrate, control, supervise, police and regulate modern societies, and the ways in which the specific institutional structures of particular states at particular moments in time may enhance or undermine such general capacities.

Second, Weber regards the modern state as wielding a monopoly of authoritative rule-making within a bounded territory. This is in turn backed by a monopoly of the means of physical violence within this same territorial space. Neo-Weberians have also sought to develop these insights. A number of neo-statists have concentrated on the mechanisms by which the state preserves (or at least seeks to preserve) its monopoly of authoritative rule-making. They have focused in particular on the question of political legitimacy, on the often democratic and/or nationalist strategies and mechanisms through which legitimacy is constructed and sustained, on the processes leading to its withdrawal (see *LEGITIMACY CRISIS*), on the consequences for the always fragile balance between coercion and consent in modern societies, and on the mechanisms through which legitimacy might be re-established (through changes of regime and, in some instances, revolution). Other neo-statists, the so-called 'war-centred state theorists', have focused on the state's supposed monopoly of the means of violence and, in particular, on the military dimension of state power. Stimulated perhaps by the intuitive appeal of Charles Tilly's remark that 'wars make states and states make war' (Tilly, 1975), such theorists have considered the war-making capacity of the state, the extent to which the internal organization of the state apparatus reflects military imperatives, and the consequences of war-making and of mobilization for war on the evolution and transformation of the state itself – in short, on the relationship between war-making and state-shaping.

As the above discussion would indicate, a substantial and rather disparate literature can trace some lineage from the Weberian conception of the state. Yet, despite this seeming diversity, neo-Weberian perspectives do tend to display certain shared characteristics – and indeed weaknesses. First, such theories have tended to concentrate rather one-sidedly on political factors internal to the state. As a consequence they have often relegated political forces outside and beyond the state, such as social movements and pressure groups, to a marginal role. Second, much neo-Weberian theory rests on the rather tenuous distinction between state and societal variables and an explanatory emphasis on the former at the expense of the latter. In the context of the attempt to 'bring the state back in' to US social science in the 1970s and 1980s, this tilting of the stick towards the side of the state was entirely appropriate. Yet now that 'state-centred' approaches have become as dominant, if not more dominant than, their 'society-centred' counterparts ever were, it is crucial that we acknowledge that the casualty of both perspectives has been the attempt to develop an understanding of the complex and ever changing relationship *between* the state and society. In recent years, a number of prominent neo-statists seem to have come to accept precisely this point and there is some evidence to suggest that the new historical institutionalism that has since emerged might provide a perspective on institutional change that is neither state- nor society-centred (see *INSTITUTIONALISM*).

Marxist and neo-Marxist approaches

If the Marxist conception of the state has been somewhat less influential than its Weberian counterpart, then the sheer multiplicity of contending (and often mutually exclusive) approaches to which it has given rise is nonetheless astonishing. This is certainly testimony to the inventiveness and creativeness of Marxist scholars, if to nothing else.

One reason for the number of rather different approaches that Marxists have taken to the study of the state is the lack of a clearly

developed theory of the state in MARX and Engels. Indeed, at least four distinctive (if chronically underdeveloped) formulations can be identified in the work of the 'founding fathers': (1) the state as the *repressive arm of the bourgeoisie*, a conception appealed to in passing in the work of both Marx and Engels, and elaborated on by Lenin; (2) the state as an *instrument of the ruling class*, the 'instrumentalist' position and that most often regarded as the Marxist theory of the state; (3) the state as an *ideal collective capitalist*, a view which derives from an incidental comment by Engels in *Anti-Dühring* and which conceives of the state as a guarantor of the general interest of capital, capable of ironing out the inherent contradictions to which it is prone and thus securing its 'expanded reproduction' over time, and (4) the state as a *factor of cohesion within the social formation* (or society), a view which also derives from an underdeveloped comment by Engels, developed by Poulantzas, and conceives of the state as performing a fundamental role in maintaining the unity and cohesion of a class-divided society.

Of these formulations, the 'instrumentalist' position developed in particular by Ralph Miliband (the second approach) and the more 'structuralist' position adopted by Poulantzas (the fourth approach) have perhaps proved the most enduring. Indeed the revival of interest in Marxist state theory in the 1970s owed much to the now (in)famous debate between these two in the pages of the journal *New Left Review*. This took the form of a dense theoretical exchange concerning the source of power within contemporary capitalist societies and, in particular, the relationship between the ruling class and the state apparatus. It revolved around the rather cryptic question: Is the modern state a state in capitalist society or a capitalist state? Instrumentalism, the view defended by Miliband, conceives of the state as a relatively neutral instrument to be manipulated and steered in the interests of the dominant class or ruling elite. The modern state serves the interests of the bourgeoisie in a capitalist society because it is dominated by that class. Instrumentalism is then a personnel- or agent-centred conception

of the state. It is, in short, a theory of the *state in capitalist society* (as opposed to the capitalist state). Change the personnel and the state is no longer capitalist.

In marked contrast, the structuralist position (defended by Poulantzas) is structure- or state-centred. It is a theory of the *capitalist state*, for it conceives of the state apparatus as a structural system whose form and function is determined largely independently of the motivations and intentions of the state's personnel. Change the personnel of the state within this schema and the capitalist character of its rule will remain.

The Miliband Poulantzas debate did not advance the cause of Marxist state theory very far, though it did perhaps point to the obvious limitations of narrowly structure- and agent-centred approaches. As such, it has provided a key point of departure for many recent developments in state theory. Here we will consider only two: the work of Fred Block and Bob Jessop respectively. Block is concerned to demonstrate how it is that, despite both the division of labour between state managers and the capitalist class and periodic conflicts between the two, the state tends to act in the long-term collective interest of capital. Following the neo-statists, he suggests that state managers may have preferences and interests somewhat different from those of the capitalist class in general. Indeed, somewhat ironically, the former may in fact have interests far closer to the long-term collective interest of capital than capital itself. The state in this formulation becomes the custodian of the general interest of capital, acting in capital's longer-term interests and often contrary to its shorter-term perceived interests. Block's position certainly represents a clear advance on that of either Miliband or Poulantzas. Yet it is still ultimately somewhat frustrating. For Block remains ambiguous as to whether capitalist reforms initiated by state managers will always prove functional for capital in the long run. If so, it is not at all clear what mechanisms generate this convenient functional fix: if not, it is equally unclear how the expanded reproduction of capital occurs in those situations where state

managers fail to act in the collective long-term interest of capital.

Ultimately more convincing is Bob Jessop's path from the legacy of Miliband and Poulantzas. Following the later work of Poulantzas himself, Jessop views the state as a strategic site traversed by class (and indeed other) struggles. Within such a perspective, there can be no guarantee that the state will act in the general interest of capital (which is hardly itself an unambiguous notion). Indeed, in so far as the function of the capitalist state is to secure the expanded reproduction of capital, the specific form of the capitalist state at a particular stage in its historical development is always likely to problematize and eventually to compromise this function. The state thus evolves through a succession of political and economic crises, precipitated by its dysfunctional and contradictory regulation of capitalist accumulation. The outcome of such crises cannot be predicted in advance. For they are, in turn, dependent on the balance of class and other forces, the strategies deployed by such forces in the ensuing struggle, and the nature of the crisis itself. Jessop's Marxism, then, eschews all forms of DETERMINISM. It offers no guarantees either of the expanded reproduction of the capitalist system or of its impending demise. In its acknowledgement of the contingency and indeterminacy of social and political change, and its emphasis on the specific institutional forms that the state takes at different moments in time in different national contexts, it displays marked similarities with the historical institutionalist perspectives developed by some neo-Weberians. It would appear that, after almost a century, there is at last some convergence between Weberian and Marxist perspectives.

Recent developments in state theory

In recent years the ascendancy of the neo-Marxist and neo-Weberian perspectives that came to dominate the revival of interest in the state in the 1970s has been challenged. Two theoretical currents are here particularly noteworthy: the development of a distinctly femin-

ist theory of the state, and the rejection of the very notion of the state by the Foucauldians and discourse-analysts.

FEMINISM, or so it is often argued, lacks a theory of the state. Yet, where once Judith Allen's comment that 'where feminists have been interested in the state their ideas on its nature and form have often been imported from outside' (Allen, 1990: 21) was certainly warranted, things are now somewhat more complicated. Some argue that feminism has no (independent) theory of the state and needs one urgently; others, that feminism has no theory of the state and has no need for one; yet others suggest that feminism not only needs, but has at last begun to develop, precisely such a theory. The evidence of recent scholarship would seem to support this latter view: in recent years feminists have indeed begun to establish the basis for very adequate and distinctively feminist theories of the state. Indeed, many of the most exciting and original developments in contemporary state theory have come from feminist scholars. Such insights include a number of key observations: (1) if the state can, in some instances, be seen to act as if an 'ideal collective capitalist', it may also be seen as a 'patriarch general' – a key site in the reproduction of relations of patriarchal domination within society; (2) with the growing feminization of poverty, ever increasing numbers of women are becoming dependent on the state for their very survival, giving the state a historically unparalleled prominence in the lives of women; (3) paradoxically, and at the same time, the state is ever more dependent on the unpaid domestic labour of women in an era of welfare retrenchment; (4) as this demonstrates, the reproduction of capitalist social relations is integrally bound up with the reproduction of patriarchal relations – an adequate theory of either must deal with their mutual articulation (see PATRIARCHY).

If, in recent years, feminists have increasingly turned to a theory of the state, then the rise of Foucauldian and discourse-analytical perspectives marks something of a counter-move *from* the state. Such approaches present a fundamental challenge to theorists of the state,

suggesting as they do that the notion of the state is itself a mystifying illusion. Following the work of Michel Foucault, they argue that the concept and discourse of the state is but one part of a broader process governing and shaping our very conduct and bringing it in line with various 'governing strategies'. State effects exist precisely because people act as if the state existed, orienting themselves to the image constructed of it. Thus, in so far as the state exists, it exists in the ideas we hold about it. This has led many theorists to reject the notion of the state altogether. Yet the idea that discourses of the state are partly constitutive of its power, authority and essence is hardly as devastating for the theory of the state as some might contend. It does, however, demonstrate that if theorists of the state are not to reproduce its mythology, they must give rather more attention to the processes through which the state is conceived, on one hand, and the relationship between such conceptions and the institutions, processes and practices of the state, on the other.

The state is dead, long live the state!

A final challenge to the theory of the state has come from a rather unexpected source. In recent years, the value of state theory has come under attack from those who reject neither its sophistication nor the significance of the insights it has generated. What they do reject, however, is its contemporary relevance. The state, they argue, in an era of GLOBALIZATION and INTERNATIONALIZATION, FINANCIAL INTEGRATION and CAPITAL MOBILITY, is rapidly becoming obsolete. It is becoming (if it has not already become) an anachronism: too small to deal with the big problems that are now reprojected on an international or global stage and too clumsy to deal with the small problems that are increasingly displaced to the local level. It is difficult to deny the appeal of such an argument. Yet it is important to treat some of the often heroic claims made about the contemporary crisis of the nation-state with a degree of caution and some scepticism. First, globalization is not a particularly novel phe-

nomenon. Indeed, it can be traced at least as far back as the imperial age. The mode of globalization has certainly changed with time, but the mere presence of globalizing forces need not herald the demise of the state form. It is certainly true that financial integration, heightened capital mobility, the emergence of regional trading blocs and the proliferation of supranational regulatory bodies significantly alters the context (economic and political) within which states operate, and may indeed be reflected in the changing form and function of the state. Yet this is in no sense to pronounce the death of the state. In all likelihood, people will continue to live, as they do now, in territorially bounded communities governed primarily by state institutions to which they continue to confer legitimacy and which they continue to regard as responsible in the first instance for the social and economic context in which they find themselves.

See also:

bureaucracy; capitalism

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COLIN HAY

statism

'Statism' or 'etatism' is not precisely defined in the literature. Embodied in the concept is the notion that the government has a major role to play in the direction of the economy, both directly through the operation of STATE-OWNED ENTERPRISES (SOEs) and indirectly through the management of the overall economy. A common usage refers to any trend towards government control of economic life, especially any situations where government (through public economic planning and the NATIONALIZATION of key industries) acquires a predominant influencing in shaping and directing the economic life of a nation. Often, but not inevitably, increased statism comes at the expense of privacy and individual liberty.

Statism has also been interpreted to mean either STATE SOCIALISM or state CAPITALISM, but this is not a particularly productive approach. More often than not, these distinctions simply set off bitter ideological controversies. In Turkey, for example, leftists maintain that Atatürk meant the former and was thus a socialist at heart, as evidenced by his creation of state enterprises: conservatives counter with the argument that he favoured big state enterprises for the practical reason that, private capital being then in insufficient supply in Turkey, industrial projects had to be undertaken by the state. Clearly statism reached its height in the centrally planned communist and socialist countries (see COMMUNISM; SOCIALISM), but exists in varying degrees in nearly all parts of the world. Its importance has also ebbed and flowed over the years.

Those opposed to statism usually cite classical economists, from ADAM SMITH onwards, who favoured a minimal role for the public sector. These economists generally saw the state's role as limited to the provision of essential public works, the maintenance of law and order, and the defence of the country. In their view, the government should guarantee property rights and the security of contracts, and should protect the economic and political liberties of individuals. These can be considered as the core activities of the public sector. To them, anything more would be considered statism.

This conservative attitude was partly a reaction to the widespread interference of government with the working of the market that had characterized eighteenth-century Europe. The classical economists considered this interference as damaging to economic activity and as an obstacle to growth. Perhaps as a consequence of this attitude and experience, the economic role of the government tended to be much more limited in the nineteenth century. For example, in most of the industrial countries, public spending was around 10 per cent of GROSS DOMESTIC PRODUCT (GDP) and LAISSEZ-FAIRE was the dominant economic philosophy.

Until recent years, the twentieth century saw a gradual but large expansion of the role of the state in the economy. Such an expansion is particularly evident from data on the growth of public spending as a share of GDP. For the new industrialized countries, that share grew on average from about 12 per cent in 1913 to about 45 per cent in 1995. Both political and ideological factors contributed to this growth. Clearly wars and the depression of the 1930s played a considerable role in the expansion of the role of the state. Perhaps even more important, however, were changes in the prevalent attitude as to what the state was expected to do. These changes in attitude were important and created the climate that made possible much of the government activism of recent decades.

Marxist and socialist thinking created strong pressures on the governments of the market economies to play a significant role in redistributing income (see MARXISM–LENINISM). The classical economists who had focused their attention on the allocative function of the state had not even contemplated such a role. The advent of communism in the former Soviet Union and later in other Eastern European countries, and the attraction that central planning had for many intellectuals in the rest of the world, pushed many countries toward a 'mixed' economy, with the government playing a central role.

Keynesian thinking (see KEYNESIAN ECONOMICS) also created pressures on the government to help sustain the disposable income of individuals during cyclical fluctuations in order to stabilize the economy. Public works programmes and unemployment compensation, together with the expansion of the public sectors and taxes with high built-in flexibility, were justified for this reason. Public pension schemes, often with redistributive features, and various forms of assistance to those whose income fell below certain levels were introduced in many countries. Public enterprises were used to maximize public employment. The goal was to build an economy with characteristics that reduced its exposure to fluctuations. Countries

with a large public sector were believed to be less subject to business cycles.

Developments in economic theory also gave credence to those wishing for increased statism. The concept of PUBLIC GOOD, which was made popular by influential economists such as JOHN KENNETH GALBRAITH, justified the government provision of many goods with the character of public goods, because it implied that without such intervention the market would simply undersupply such goods. The private sector would not have an incentive to produce public goods, due to the difficulty of excluding from their use those individuals who would not contribute to the cost of their production (that is, free riders).

Closely related to public goods was the concept of externality. The recognition that consumption or production of some goods may generate positive or negative EXTERNALITIES not reflected in the price of these goods, created a further case of market failure requiring governmental intervention. Again the argument for increased state involvement in these areas was that, without government intervention, the market would underproduce or overproduce such goods depending on whether the externalities were good or bad.

In addition to the factors mentioned above which influenced the behaviour of the governments of all countries, arguments of particular relevance for developing countries were also advanced. The earlier literature on economic development often assumed that governments had abilities lacking in the private sector. For example, one of the arguments used to justify the government's role in direct production activities (through public enterprises) was that managerial skills were lacking in the private sector. Another was that, because of their large scale, some activities or projects required amounts of capital or a degree of expertise that only the public sector could generate or assemble. Still another was that information essential for the successful conduct of some activities was more available, or was only available, to the public sector.

In the 1950s and 1960s, especially in developing countries, it was often assumed that the

government was the best judge of which goods were 'essential' or 'necessary'. It penalized the production or prohibited the use of some resources (credit or foreign exchange) for the provision of 'non-essential' or luxury goods. In many countries, high levels of protection were granted to firms producing 'necessary' goods.

Summing up, statism in its various forms and degrees connotes a broad policy approach common to many mixed economies in which the state intervenes extensively in the development process. Although market forces usually continue to play an important role, statist strategies are commonly motivated by structuralist analyses (see STRUCTURALISM) of economic development that stress the need for assertive government action to remedy intractable market failures and supply constraints. At the most general level, economic statism reflects a preference for administratively guided resource allocations, rather than autonomous allocations by the market. Critical decisions regarding prices, supply, trade and distribution are determined by government fiat. Statist regimes emphasize indicative planning to guide public and private investment. They also impose a broad range of economic regulation on both domestic and foreign capital. Moreover, they rely heavily on state enterprises to provide strategic goods, subsidies, employment and services.

In the spectrum of modern capitalist economic systems, statism is often grouped under state capitalism or producer capitalism:

Consumer capitalism

Examples	Australia, Canada, United Kingdom and United States
Traits	Laissez-faire, open borders, small government, profit mentality
Potential problems	Income inequality, low savings rates, weak governments

Statism/producer capitalism

Examples	France, Germany, Japan, Mexico and Turkey
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Traits	Emphasis on production, employment, state regulation/production
Potential problems	Fraying of social safety net, slowing innovation, lack of competitiveness, consumer dissatisfaction

Family capitalism

Examples	Indonesia, Malaysia, Taiwan and Thailand
Traits	Extended clans dominate business and capital flows
Potential problems	Creating modern corporate organizations and money markets

Frontier capitalism

Examples	China and Russia
Traits	Government pursues business-for-profit activities, entrepreneurial class evolves
Potential problems	Must establish rule of law, open borders, curb criminal activity

Critics of economic statism, largely from the neo-classical perspective (see NEO-CLASSICAL ECONOMICS), emphasize a standard set of policy effects as a basic hindrance to development performance. Such analysts have argued generally that excessive political intervention creates an array of inefficiencies and market distortions. Statist economies reflect a cluster of problems, including overvalued exchange rates, fiscal deficits, indebtedness, cumbersome administrative restrictions on trade and foreign exchange, arcane and inconsistent REGULATION, unwieldy and wasteful state enterprise and pervasive corruption. This syndrome fosters widespread misallocation of resources and a chilling effect on investment and growth.

In recent years much of the attack on statism has centred on the role of STATE-OWNED ENTERPRISES (SOEs) – public corporations owned and operated by government. Especially during the 1950s, 1960s and 1970s, there was a rapid growth in the number and size of these

firms. In addition to their traditionally dominant presence in utilities (gas, water and electricity), transportation (railways, airlines and buses) and communications (telephone, telegraph and postal services), SOEs became active in such key sectors as large-scale manufacturing, contracting, finance, services, natural resources and even agriculture.

Critics contend that SOEs often make disproportionate demands on resources, many of which are ultimately underutilized or wasted. In many cases, the level of these demands is related to low profitability and inefficiency. Surveys of SOEs often reveal a common situation (taking into account interest payments, subsidized input prices and taxes, and accumulated arrears) was one of large deficits. Most SOEs in developing countries fail to show a profit. In turn, these deficits constitute a massive drain on government resources. Studies have also suggested that SOE labour and capital productivity is generally lower than in the private sector.

Several factors contribute to the overall poor performance of SOEs in terms of profitability and efficiency. Perhaps the most important is that SOEs differ from private firms in that they are expected to pursue both commercial and social goals. Providing goods at prices below cost in an effort to subsidize the public or hiring extra workers to meet national employment objectives inevitably reduces profitability. Another factor adversely affecting the profitability and efficiency of SOEs is the excessive centralization of their decision-making, which allows little flexibility for managers in the everyday operation of the firm. An additional problem is the bureaucratization of management: many decision-makers are not accountable for their performance and little incentive is provided for improved decision-making. Finally, despite the abundant labour supply and the employment mandate, access to capital at subsidized interest rates has often encouraged unnecessary capital-intensiveness.

For the most part, however, the problems that have plagued many public corporations in developing countries are not beyond solution. Two alternative options typically mentioned

are (1) reorganization with a greater bottom-line focus for the SOE, and (2) the transfer of ownership and control from the public to the private sector (a process known as **PRIVATIZATION**). For the first option, decentralizing decision-making to allow for more flexibility and providing better incentives for managers could increase production efficiency. Providing capital at its market rate may eliminate the bias towards capital-intensiveness. For example, the Chinese government took important steps in this direction when it gave greater autonomy to encourage increased competition among its numerous SOEs in late 1984. In short, public corporations can still play an important role in economic development, as long as the political will is there to minimize abuse of power and the economic will is there to correct socially unnecessary price and market distortion.

The second option, the privatization of SOEs in the production and financial sectors, hinges on the neo-classical hypothesis that private ownership brings greater efficiency and more rapid growth. During the 1980s, privatization was actively promoted by major international bilateral (USAID) and multilateral agencies (WORLD BANK, INTERNATIONAL MONETARY FUND (IMF)). Many developing countries followed this advice, although the extent to which this was due to their philosophical agreement as opposed to financial pressure exerted by the funding agencies remains unclear. In addition to the belief that privatization improves efficiency, increases output and lowers costs, proponents argue that it curbs the growth of government expenditure, raises cash to reduce public internal and external debt, and promotes individual initiative. Finally, supporters of privatization see it as a way to broaden the base of ownership and participation in the economy, thereby encouraging individuals to feel that they have a direct stake in the system.

But privatization raises many complex issues. There are questions of feasibility, appropriate financing, the structure of legal and property rights, the role of competing elites and interest groups (for example, public officials and bureaucrats versus domestic and foreign private business interests) and whether

or not widespread privatization promotes or ultimately weakens existing dualistic economic, social and political structures. It is not sufficient to claim (as many free-market economists do) that privatization can lead to higher profits, greater output or even lower costs. The key issue is whether such privatization better serves the long-run development interests of a nation by promoting a more sustainable and equitable pattern of economic and social progress. Despite all of the ideological rhetoric by free marketeers on this issue, the evidence so far is less than persuasive. Nevertheless, there is great momentum towards privatization throughout the contemporary developing world.

While statism is now definitely in retreat when compared to the past, its future is intertwined with the process of GLOBALIZATION. In the 1970s, it was argued that globalization was rendering the NATION-STATE – and with it statism – obsolete. The expectation was that it would severely limit the range of action that states could take. The state would gradually become less and less important to its citizens as interdependence rose. This debate aroused much controversy and inspired a strong defence of the continuing relevance of the state in shaping domestic economic affairs.

In the 1990s, this debate has been revived as globalization reached new heights. Three issues are central to it. First, globalization has been seen as exerting pressure on all states to change their policies and institutions in certain ways. Globalization, it is argued, is forcing CONVERGENCE in policies among the countries most exposed to it. Liberalizing trade policy, removing capital controls, opening financial markets to foreign investors and downsizing the role of the state in the economy are the generic policy prescriptions for effective participation in a global economy. Pressure for the reduction (or even abandonment of) the WELFARE STATE in developed countries and for the LIBERALIZATION of the economy in developing ones has been seen as a by-product of globalization.

Second, globalization has been seen as giving increased power to the holders of capital – investors, MULTINATIONAL CORPORATIONS (MNCs) and global financial institutions.

These actors now can demand that states make changes in their economic policies and can punish them if they do not comply by exiting the country or, better yet, speculating against the country in world currency markets. In contrast, labour has been weakened. Having less freedom to move from country to country, workers find their power to bargain with firms impaired. Membership in unions worldwide has declined and unions have faced challenges to their acquired power in many states. Globalization moves jobs around the world and imposes constraints on wage increases as never before.

Finally, globalization, it is sometimes claimed, is irreversible. That is, no actor can resist its advance. This again calls into question the role of the nation-state. Can any state resist, or even reshape, the pressures generated by global markets? Or must a state submit to the ineluctable pressures of globalization and lose the capacity to direct its own national economy?

There is not much of a consensus on any of these issues. Although many events seem to support the above views – the rush to FREE TRADE and capital market liberalization, the reforms of many welfare states and the creation of independent central banks globally – some critics have seen the other side of the coin. They note that the percentage of government spending in the economy has declined only slightly or not at all. Countries have maintained extensive and distinct welfare systems, national ways of doing business have persisted and unions have actually undergone a resurgence lately in some nations, including France and the United States.

These events suggest that globalization is neither producing convergence nor undermining labour, and that it may not be irreversible. States are, in fact, ever more important: they are the means for countries to resist and reshape the pressures generated by globalization. In this view, strengthening the institutions of the state may be the most effective way for countries to reap the maximum benefits from a world of global markets. In sum, these contradictory perspectives on globalization and the

state-owned enterprises (SOEs)

implications for statism are likely to persist for some time.

See also:

mercantilism; neo-mercantilism

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ROBERT LOONEY

state-owned enterprises (SOEs)

State-owned enterprises (SOEs), representing governments' direct intervention in economic organization, go back to early times and (until recently) exhibited a historic tendency to proliferate, particularly in the hundred years or so that ended in the 1970s. For the past two decades, however, the economic territory occupied by these entities has been contracting.

In antiquity, when SOEs first appeared, they were economic undertakings that formed part of a ruler's patrimony. Usually designed for fiscal purposes (for example, salt monopolies, royal ownership of precious metals deposits), they were also established to organize large-scale irrigation systems or, later, to provision the ruler's household and retinue with speciality products.

As the INDUSTRIAL REVOLUTION spread in continental Europe, public enterprises centred on developmental functions: for example, canal building, railway construction, electricity and gas works, and (in time) telecommunications systems. The Prussian coal mines and iron-works in Upper Silesia were in the vanguard of modern industry in that country. The Tsarist government came to own a preponderant portion of Russia's railway system by the 1890s. Japan, after the Meiji Restoration, is a prime example, for there the imperial government served as entrepreneur in a variety of key industrial fields. As numerous scholars have observed, direct intervention in one form or another tended to be a policy feature of most late industrializers. Even in countries that relied more on private initiative, as in the United States and late-nineteenth-century Latin America, public subsidies (financial and land grants) were employed, sometimes lavishly, to stimulate investment in (for instance) port works and railway development.

The 1930s and 1940s brought a widespread expansion in the operations of SOEs, partly in reflection of changing political ideologies and partly for pragmatic reasons. NATIONALIZATION was used to give the state control of the commanding heights of the economy, but also

to maintain production and employment in firms that were failing in the GREAT DEPRESSION, as in the *Institute per la Ricostruzione Industriale* in Italy or the Reconstruction Finance Corporation in the United States. Outside the United States, the state also took over many bankrupt utility and railway companies. Official crop-marketing boards were set up to support farm incomes (the earliest such programme had begun years earlier in Brazil to stabilize coffee prices). Banking institutions were established to assist the sales of exporters and to finance new industrial and other operations. The Tennessee Valley Authority, the first of the large multipurpose river-basin development agencies, illustrated a growing tendency to invest SOEs with multiple functions.

This was the period, too, in which governmental operation of development banks and basic industries – steel, chemicals and a variety of other manufactures, airlines, power-generating systems, petroleum and other mining – spread widely in Latin America and Turkey, setting a policy precedent for other developing economies, like India, Pakistan, Indonesia, Ghana, Egypt and so on. On the European continent likewise, a mixture of motives in the post-war era expanded the operations of public enterprises in Italy, France, Sweden, Austria, Germany, Spain and the United Kingdom.

The Soviet Union represented a maximal augmentation in the scope of SOEs, initially during war communism and again during the Stalinist Five-Year Plans that followed the NEW ECONOMIC POLICY (NEP) episode of the 1920s (see STALINISM). On both occasions the impetus came from an ideological commitment to central planning and collectivized ownership. As the Soviet Union dominated more and more territory after World War II, there was a corresponding increase in the role of SOEs. Nowhere was this more evident than in the People's Republic of China (PRC) at the end of the 1940s or later in Cuba.

It remained for the post-war era to systematize the use of SOEs as instruments of public policy, partly because a theoretical case (built on the concept of MARKET FAILURE and

Keynesian analysis – see KEYNESIAN ECONOMICS) had been developed and partly because so much credit was transferred through official channels into the various undertakings initiated by state development authorities. Within a few years, reliance on parastatal enterprises as instruments of development became well-nigh universal. Throughout the developing world it was assumed that private initiative was not up to the task of producing accelerated structural change on account of high risk levels, inadequate capital markets and inexperience. Although foreign enterprise could supply some of these gaps and also transfer more advanced technologies, there was a marked disinclination to allow it unfettered access to the new policy-induced investment opportunities, for fear of wholesale denationalization of the control of resources.

Much has been written about the developmental role of the SOEs that exploded in number in the 1950s, 1960s and 1970s. In time, however, their shortcomings became increasingly evident. Suffice it to note that, with poorly trained (and often politically appointed) managers, the vulnerability of SOEs to political pressure, the weakness of administrative and legislative oversight agencies, and their ability to turn to public treasuries to cover deficits and finance capital expansion, plus their ability to borrow abroad with the implicit backing of sovereign credit, these enterprises (especially in the developing world) often grew increasingly inefficient and burdensome on the economies in which they operated. After 1989, it transpired that the public enterprises of centrally planned economies suffered many of the same defects – compounded by the divorce of economic decision-making from any semblance of meaningful market signals to indicate relative scarcities and preferences. In the industrially advanced countries of Europe, the constraints of regional INTEGRATION eventually impinged on the conduct of parastatal companies, forcing them, in many fields, to simulate the operations of private corporations. The professionalism of managers who moved between public and private sectors underscored this development. Indeed, in many cases the

sterilization

state's companies began to form joint ventures with private investors and to market a portion of their shares on national capital markets, both of which developments hastened their *de facto* transformation into companies much like those of the private sector.

Starting in the 1970s, with Chile and the United Kingdom taking the lead, privatization began to gather momentum, hastened along by the international DEBT CRISIS of the 1980s. After the collapse of the centrally planned economies, privatization became a centrepiece of economic restructuring programmes around the world. As the SOEs have been closed down, merged, sold off to the private sector or reorganized to operate along commercial lines, the expectation has grown that crowding out, deficit financing and inflationary pressures will abate and that the stronger fiscal systems that ensue will be more adequately positioned to deal with social investment needs.

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WILLIAM P. GLADE

sterilization

Sterilization occurs when the national monetary authority intervenes in the financial market by buying or selling financial securities to neutralize the tendency of BALANCE OF PAYMENTS surpluses and deficits to alter the domestic money supply. Increasing levels of CAPITAL MOBILITY in the contemporary international economic system mean that sterilization does not work. This is because the amount of international funds that can be withdrawn if domestic INTEREST RATES fall below world levels exceeds the government's foreign exchange reserves. The government will have to concede to the speculators.

See also:

bonds; exchange rate

ALISON M.S. WATSON

sterling area

The sterling area, lasting with varying membership from the early 1930s until 1979, was a set of countries whose currencies were fixed to the British currency and who held most of their foreign exchange reserves as sterling balances in London. The catalyst for its creation was Britain's departure from the GOLD STANDARD in September 1931. Countries heavily dependent on London's financial markets or with close trade links to Britain had a strong incentive to tie their currencies to the new floating value of sterling. These included most of the British Empire (except Canada, Newfoundland and Hong Kong – see EMPIRE, BRITISH), Scandinavian countries, Portugal and some countries in the Middle East (such as Persia, Iraq and Egypt). In 1939, the

membership narrowed to include primarily just imperial countries, as the loosely organized sterling area became the more formal 'sterling bloc' with the introduction of common exchange controls and the pooling of foreign exchange reserves. After 1945, the bloc remained in place, but membership gradually diminished in the context of Britain's declining power, the growing independence of former colonies, the devaluation of the pound in 1967 and its flotation in 1972.

See also:

London, City of

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ERIC HELLEINER

stock markets

Stock markets are CAPITAL MARKETS – that is, markets where EQUITIES or stock are exchanged. While debt securities (such as BONDS) are also traded through these markets, increasingly these are identified separately as the bond markets. For the most part, then, we can say that stock markets are where an ownership interest in corporations is bought and sold.

In stock markets, both newly issued and old securities are traded. Indeed, a stock market is two markets in one: a primary market and a secondary market (see MARKETS, PRIMARY).

L.S. TALANI

Stockholm Convention

The Stockholm Convention established the EUROPEAN FREE TRADE ASSOCIATION (EFTA) on 4 January 1960. Iceland, Liechtenstein, Norway and Switzerland are the current members. The convention's main goal is to liberalize trade relations among its members by eliminating all QUOTAS and import DUTIES.

J. ANDREW GRANT

Strange, Susan (1924–99)

Susan Strange was instrumental in establishing the study of INTERNATIONAL POLITICAL ECONOMY (IPE) outside the United States. After working as a journalist for *The Economist* and *The Observer* after the war, Strange moved into academia via the Royal Institute of International Affairs (RIIA) during the 1960s. Through her own writings, her work in the International Studies Association, her founding and long-term role in the British International Studies Association and the many students she taught, Strange had a major impact on the study of IPE and INTERNATIONAL RELATIONS (IR). This continued through her work at the London School of Economics, University of Warwick and European University in Florence.

At the RIIA, Strange initially developed the first of three identifiable strands in her work. Then and after, she wrote extensively on the politics of the FINANCIAL STRUCTURE (Strange, 1976; 1986; 1994). Her key concern was the STRUCTURAL POWER that the creation of CREDIT delivers. She also argued that the global FINANCIAL CRISIS is not accidental, but a direct result of US fiscal policy and self-interest. Her

book *Casino Capitalism* (1986) both analysed this crisis and suggested its name!

The second strand to her work was a critical engagement with IPE and IR, arguing that both disciplines suffer from ‘a dialogue of the deaf’. Suggesting that the ‘mutual neglect’ between the study of IR and international economics did not reflect the interaction between politics and economics in the international system, Strange worked to develop a new IPE, which included expanding the discipline’s research agenda to consider non-state actors in a wider manner than REGIME THEORY had allowed (Strange, 1982).

The third strand of Strange’s work is presented most fully in *States and Markets* (1988). Unable to accept the United States-in-decline thesis (Strange, 1987), she developed a theoretical model of structural power which suggests that the United States still enjoys a dominant position in the international political economy. However, unlike other writers, Strange suggested the problem is that US politicians need to recognize their global responsibilities, rather than acting defensively from a perceived position of decline.

For Strange, the key issue IPE needs to be concerned with was the bargains that are struck between authority and markets. The way to understand these bargains is through an analysis of the security structure, PRODUCTION STRUCTURE, financial structure and KNOWLEDGE STRUCTURE. These structures then inform the bargains that are made: which values within the global system are privileged and which are given less weight.

In the 1990s, Strange developed out of this concern for structural power the idea of ‘triangular diplomacy’ (Strange, Stopford and Henley, 1991). This approach explores state–state, firm–firm and state–firm relations to locate three avenues along which structural power may be aligned in its effects on the bargains between authority and markets.

Strange never suggested that her work should be taken up without criticism by acolytes, rather she saw herself as providing a tool kit for the investigation of the international political economy. Subtitled the inno-

vative *States and Markets* ‘an introduction’ was characteristic modesty! She developed a critical IPE which puts at centre-stage the question: *Cui bono?* – Who benefits? Only by answering this question can we identify the loci of structural power and the implications for the international political economy.

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CHRISTOPHER MAY

Strategic Defense Initiative (SDI)

The Strategic Defense Initiative (SDI) was the brainchild of US President Ronald Reagan, who called on US scientists in the early 1980s to develop a 'peace shield' that would protect the United States and its allies from ballistic nuclear missiles. The proposal met with derision from many analysts, media commentators and critics of Reagan's hardline stance against the Soviet Union. They dubbed SDI 'Star Wars' – a name that has stuck for nearly two decades.

Following Reagan's call, the US government undertook a costly programme to develop land- and space-based SDI weapons. Estimates of its cost were staggering, ranging from hundreds of billions to trillions of dollars. But SDI would not have worked as Reagan envisioned. Each COLD WAR superpower had roughly ten thousand nuclear warheads. Even if SDI were 99 per cent effective – a fanciful expectation – the Soviets could destroy a hundred US cities. They could complicate even this scenario by adding inexpensive decoys to their missiles. This crude arithmetic shows how wishful was the thinking of the SDI advocates.

Another fundamental problem with SDI was that it undermined the system of mutually assured destruction (MAD) that had (apparently) deterred both the United States and the Soviet Union from launching a nuclear first strike. MAD worked because both sides knew that a first strike would leave the opposing side with enough missiles to ensure a devastating second retaliatory strike. SDI would give the United States an advantage: it could launch a first strike and use SDI to destroy missiles that were part of the Soviet response. This was inherently destabilizing because the Americans would no longer have an incentive not to attack and because the Soviets would have an incentive to launch a first strike before SDI

was fully developed and deployed. Furthermore, SDI would be a violation of the 1972 Anti-Ballistic Missile Treaty, which limited anti-ballistic missile systems precisely to ensure the maintenance of MAD.

The Soviet government strongly opposed SDI because they saw SDI technologies as having dangerous offensive potential – and because they could not afford to develop a similar system. They argued that a space-based laser or interceptor, along with its detection equipment, could be used to detect and destroy Soviet missiles and other weapons on the ground. Unable to persuade Reagan to stop the SDI programme, Moscow used it as justification for being uncooperative in arms control negotiations. However, Soviet President Mikhail Gorbachev continued to participate in arms talks and, after he agreed to the Intermediate Nuclear Force Treaty, the US Congress decided to limit funds for SDI. Some analysts suggest that the SDI programme contributed to the end of the Cold War, by showing the Soviets that they could not compete with US military development.

The US Department of Defense claimed that its ballistic missile defence programme had beneficial economic effects, primarily through TECHNOLOGY TRANSFER to the private sector. According to them, ballistic missile defence technologies contributed to hundreds of new commercial products worth several hundred million dollars, thereby creating new jobs and benefiting taxpayers. These benefits are, of course, tiny when compared to the billions of dollars spent trying to develop strategic missile defences.

In the 1990s, there was renewed interest in more limited versions of SDI. The success of anti-missile defences generally (including the much-vaunted Patriot missile that performed so poorly in the GULF WAR) was very limited at best. However, the ballistic missile threat from China, fears of North Korean missiles threatening US troops and allies in East Asia, and the potential proliferation of missiles to rogue states and terrorists, provided ample stimulus for continued research and development (R&D) of defensive missile systems.

strategic interaction

See also:

Keynesianism, military; military-industrial complex (MIC)

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PAUL G. HARRIS

strategic interaction

A 'strategic interaction' exists whenever the outcome of a situation depends on the choices of two or more actors. Any situation of INTERDEPENDENCE (that is, mutual dependence of actors on each other) is a case of strategic interaction. Examples include the strategic interaction among cartel members to restrict output to raise prices (see CARTELS), the strategic interaction between NATION-STATES crafting a global warming agreement or the strategic interaction between lenders and creditors in an international debt crisis. In each case, none of the parties can determine the outcome by itself and each has to anticipate how others will behave in order to determine its own best policy.

The significance of strategic interaction can be seen in the difference between GAME THEORY, which is a theory of strategic interaction among multiple actors, and decision theory, which is a theory of choice by an individual actor. In decision theory, an actor chooses its best course of action in an

environment that is exogenous and invariant with respect to its own decisions. This choice may be very complicated because of the technical nature of the problem and it may involve uncertainty about the state of the world. But these factors are strictly exogenous to the model and, most importantly, are not affected by the individual's choice. Thus a decision-theoretic actor may make a decision contingent on the state of its environment (for example, if it is likely to rain, I will take my umbrella) but the environment is never contingent on its decision (taking along my umbrella does not alter the likelihood of rain).

By contrast, in game theory there is more than one actor and the (potential) choices of each actor constitute part of the environment of other actors. An actor cannot choose its best course of action without taking into account the possible choices of other actors: conversely, the choices made by other actors may be affected by the choice of the first actor. Now contingency runs in both directions. An actor may make its decision contingent on others' decisions (for example, I will cooperate, if you cooperate) and others' behaviour may be contingent on its decision (they will cooperate, if you cooperate). Now part of an actor's environment – that is, the part constituted by other actors – is endogenous, in the sense that it may be affected by the actor's behaviour.

Interactions are strategic when actors' decisions are made with an eye towards influencing others' decisions. Strategic interactions are most interesting when they combine common and conflicting interests. If interests are strictly harmonious, then everyone is made best off when each pursues their own interest. By contrast, when interests are strictly opposed (in the two-actor case), then each actor individually maximizes their well-being at the direct expense of the other. In either situation, there is no need for politics or any type of coordination. But when common and conflicting interests are mixed together, joint incentives to pursue mutual benefits are mixed with individual incentives to take care of oneself. Sometimes this leads to perverse situations.

The nature of strategic interactions depends

on many factors, including the number of actors, their capabilities, their preferences, their information and the institutional setting. Although there is an infinitude of combinations, a small number of 2×2 games have been widely used to represent the most important and intriguing strategic interactions involving two players. These games are reproduced below. Each matrix represents a combination of simultaneous choices by two players, one of whom chooses the top or bottom row and the other who chooses the left or right column. The numbers in each cell reflect the resulting payoffs to (Row, Column) respectively. Predicted outcomes (or equilibria) are circled.

In 'PRISONERS' DILEMMA', if both actors makes their preferred choice, each is worse off than if *both* had taken their other alternative. This strategic interaction underlies a wide range of situations including the TRAGEDY OF THE COMMONS, COLLECTIVE ACTION problems and multi-sided EXTERNALITIES. The actors can do better if they can find a way to make their behaviour contingent on each other's behaviour to create incentives for cooperation. The 'folk theorem' shows that if a game is repeated through time and actors value future payoffs sufficiently, then they can achieve cooperative (3,3) outcomes. They do so by using conditional approaches like the TIT-FOR-TAT STRATEGY whereby each side reciprocates the other's behaviour in the play of the game immediately previous to the current one. Through such strategies, actors affect each other's behaviour and thus the ultimate outcome.

The strategic interaction in 'coordination' games is that the actors are primarily concerned with coordinating their choice with the other actor. In pure coordination games, both actors are indifferent over where they coordinate, whereas in the 'battle of the sexes' game (shown) each prefers to coordinate but at a different point. This strategic interaction underlies problems such as setting INTERNATIONAL STANDARDS for communication and transportation or the choice among alternative cooperative agreements that are mutually beneficial but with different distributive consequences.

In 'chicken' games, each actor seeks a dominant position that subordinates the other. The dilemma is that if both push for dominance, mutual disaster (1,1) results. So each would be better off accepting a situation (3,3) in which neither is dominant – but this outcome is not stable in the sense that both actors will be tempted to deviate from it to establish dominance (for example, at (2,4) or (4,2) respectively). Chicken is often used to represent crisis situations (such as nuclear brinkmanship) or bargaining situations in which a long-term breakdown may result if a settlement is not reached.

Finally, the 'assurance' game (also known as 'stag hunt' or the 'security dilemma') appears harmonious since both sides prefer to be in the top-left cell, which is one equilibrium outcome. Unfortunately, if the worst payoff – (1,3) or (3,1) respectively – for each is sufficiently bad, the two sides might end up at the inferior lower-right equilibrium. For example, if the Row actor is concerned that the Column actor

2, 2	4, 1
1, 4	3, 3

Prisoners' dilemma

4, 3	1, 1
1, 1	3, 4

Coordination (battle of the sexes)

3, 3	2, 4
4, 2	1, 1

Chicken

4, 4	1, 3
3, 1	2, 2

Assurance (stag hunt)

Figure 12 Examples of strategic interaction

strategic partnership

does not understand that they are both better off at top-left, or if Row fears that Column might make a mistake in its choice, then Row should choose bottom to protect itself from a possible catastrophe if top-right occurs. Of course, if Column thinks that Row might be thinking this way, then Column must pick right to avoid a catastrophe at bottom-left. This reinforces Row's concerns and a vicious circle ensues. The net result is that prudential play might lead the actors to bottom-right, even though this is distinctly inferior to top-left.

Strategic interactions also depend on a variety of other factors not captured in the structure of these 2×2 games. One is information: the preceding assurance example illustrates the vital importance of information and mutual expectations, even when pay-offs themselves are fully known. Extensive-form (tree) games provide an important analysis of such dimensions of information as 'costly signalling' and 'cheap talk' (Morrow, 1994). They further illuminate the impact of sequential (as opposed to simultaneous) choices. This opens up a wide variety of important considerations, including agenda-setting, threats and commitments. Even in the 2×2 games above, we can see that if Row can move first in chicken or coordination then it is able to assure its preferred outcome; whereas even if Column informed of Row's prior move, it can do no better than adapt to it.

Another important variation in strategic structure comes with changing numbers of actors. A striking example is that the conventional wisdom that cooperation is impossible in ZERO-SUM GAMES is correct only for two actors; once there are three or more actors, there is room for cooperation. The reason lies in the possibilities for coalitions where one group cooperates at the (zero-sum) cost of another group. Similarly, increasing the number of actors in prisoners' dilemma creates the complex of strategic interactions analysed by COLLECTIVE ACTION theory, which argues that small group settings differ fundamentally from large group settings.

Finally, strategic interactions are shaped heavily by the institutional context. The 'rules

of the game' – including both the rules shaped prior to and outside the current issue, and the 'endogenous' rules created by actors through their strategic interactions – are a fundamental part of any strategic setting. The study of grand theoretical topics like cooperation and institutions, as well as the study of more practical policy issues such as how to manage open markets or limit global warming, can each be conceived as ways to achieve better outcomes in existing strategic interactions. An especially important way to do this is by creating norms, rules and other institutional arrangements that alter the strategic interaction in mutually agreeable ways.

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DUNCAN SNIDAL

strategic partnership

There are two definitions of the term 'strategic partnership' that are relevant to any explanation of the INTERNATIONAL POLITICAL ECONOMY (IPE). The first is related to the conduct of the relationship between firms in the global economy, especially transnational corporations (TNCs). In particular, one of the most significant developments in the global economy in recent years has been the growth and spread of strategic alliances – various forms of collaboration – between firms at an international scale. They arise from the kinds of changes that have been occurring in the global economy, notably intensification of competition, acceleration in TECHNOLOGICAL CHANGE, and increased costs

of developing, producing and marketing new products. The major objective of a strategic alliance is to enable a firm to achieve a specific goal that it believes it cannot achieve on its own. In particular, an alliance involves the sharing of risks as well as rewards through joint decision-making responsibility for a specific venture. Strategic alliances are not the same as mergers, in which the identities of the merging companies are completely subsumed. In a strategic alliance only some of the participants' business activities are involved. In every other respect the firms remain not only separate but also often compete with their strategic alliance partners.

The second type of strategic partnership relevant to the examination of the contemporary IPE are the strategic partnerships or 'alliances' that occur between states (see STATE, THE). First, these are significant because the pattern of INTERNATIONAL TRADE tends to complement a state's strategic political partnerships – in other words, 'trade follows the flag'. One reason for this is that states that are used to working together politically will find it much easier to then embark on an economic relationship. Another reason is that allies do not want to give their enemies an unfair advantage by bolstering their economies through increased trade. They will therefore tend to create trading relationships with states with which some form of strategic partnership already exists.

The second reason why strategic partnerships between states are important for the study of IPE lies in the fundamental relationship between economics and politics that an alliance represents. For example, in a groundbreaking article, OLSON and Zeckhauser (1966) developed an economic theory of alliances by characterizing deterrence as a pure PUBLIC GOOD – that is, one that must be supplied communally. By doing this, Olson and Zeckhauser were able to make a number of assumptions regarding the nature of alliances. First, they predicted that defence burdens would be shared unequally between allies. The more defence a nation's allies provide, the less that nation tends to spend on defence. Those allies that are large and wealthy will thus

have a larger defence burden than those that are smaller and less economically successful. Moreover, because the larger members of an alliance generally place a higher value on security and protection, they will usually devote larger shares of their national income to defence than smaller nations. In this case, there will be a FREE RIDER PROBLEM, whereby some states will rely for their defence on others in the alliance. Second, defence expenditures were anticipated to be at inefficient levels compared to some sort of ideal standard. The reason for this is that it is political imperatives that drive membership of an alliance. Thus thoughts of economic efficiency are often secondary. Independent states make choices regarding their defence policy on the basis of their individual national interests and not on the basis of the collective group interests. Third, it is not necessary to restrict the size of an alliance, because any increase in the size of the alliance will result in costs being shared, while the same level of defence is maintained. Finally, an ally's demand for defence will be dependent on such factors as the relative prices of defence inputs, the income of each ally, the level of defence expenditures of the other members of the alliance and the perception of threat.

Analysing alliances in these terms is important for a variety of reasons. First, economic investigation of alliances allows conclusions to be drawn about the nature of the defence burden that the alliance has to share, as well as about the actual composition of the alliance. Second, the development of an economic approach to alliance membership has been used to derive various models of alliance behaviour that can be then used as an aid in predicting future behaviour.

One of the most significant strategic partnerships between states in the contemporary international system is the NORTH ATLANTIC TREATY ORGANIZATION (NATO). Membership of NATO is based on meeting alliance force requirements and common standards to ensure those forces can operate with one another. The organization funds the procurement of equipment and facilities needed to accomplish their

strategic trade theory

common goals. Membership costs comprise a financial contribution to the funding of NATO's common infrastructure (for example, airfields, communications, radar warning systems), a commitment of national forces to the alliance, acceptance of NATO defence strategy (including a commitment to the modernization of forces) and the provision of bases for foreign troops. In return for these expenditures and commitments, NATO members benefit from collective defence, including the protection offered by the strategic nuclear forces of the United States.

Examining NATO in the 1960s, Olson and Zeckhauser discovered that there was a significant positive correlation between an ally's GROSS NATIONAL PRODUCT (GNP) and its ratio of military expenditure. Thus wealthier allies assumed a greater defence burden than poorer allies. Although research during the late 1960s and 1970s seemed to suggest that this no longer seemed to apply to NATO – smaller allies had taken on a greater portion of the defence burden – developments in the post-COLD WAR world are likely to demonstrate that established members have to support new members for at least an interim period. For example, Poland, Hungary and the Czech Republic formally became part of NATO in March 1999. This means that the mutual guarantees of assistance in time of war that have been the essence of NATO for several generations have now been extended to these three. If any of them are attacked, then it is the legal and moral obligation of all NATO members to come to their assistance. This dramatically increases both the responsibilities and vulnerabilities of NATO. It may, of course, also increase the opportunities. Estimates of the cost of NATO expansion to include Poland, Hungary and the Czech Republic range from about US\$27 billion to US\$35 billion from 1997 through 2009. The share of these costs borne by the United States has been estimated at between US\$1.5 billion and US\$2 billion, approximately 20 per cent of the total cost, and other estimates have ranged considerably higher. Moreover, there will certainly be additional

costs associated with subsequent decisions to invite additional countries to join NATO.

See also:

alliances, inter-firm; General Agreement on Tariffs and Trade (GATT); liberalization; multinational corporations (MNCs)

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ALISON M.S. WATSON

strategic trade theory

'Strategic trade theory' is trade theory based on imperfectly competitive markets (see IMPERFECT COMPETITION). Strategic trade theory argues that increasing returns can be an independent cause of international specialization as a result of first mover advantage and dynamic ECONOMIES OF SCALE. Thus it allows for strategic behaviour by governments in the furtherance of national advantage.

The theory of COMPARATIVE ADVANTAGE tells us that countries should specialize in the production of goods and services they can produce more efficiently. The HECKSCHER–OHLIN–SAMUELSON (HOS) MODEL OF TRADE explains comparative advantage in terms of differences in FACTOR ENDOWMENTS between countries. Countries will have a comparative advantage in the production of goods that use their most abundant factor more intensively and will have a comparative disadvantage in

the production of those goods that make use of their relatively scarce factors of production more intensively. The HOS proposition has formed the foundation of most of traditional TRADE THEORY and it explains comparative advantage in terms of differences in relative factor endowments between trading countries. The development of this theory required, among others, the assumptions of perfectly competitive markets (see PERFECT COMPETITION) and constant returns to scale. Given these assumptions, trade policies such as subsidies were seen as unambiguously harmful (Grossman, 1992).

Two empirical observations confront traditional theory. First, a large part of international trade cannot be credibly explained by differences in national patterns of comparative advantage. The theory cannot explain intra-industry trade (see TRADE, INTER-INDUSTRY AND INTRA-INDUSTRY), which forms a significant part of international trade. Second, the assumption of perfectly competitive markets is not tenable. Large firms with significant MARKET POWER conduct much of international trade and most trade is in products of industries in which firms enjoy economies of scale and do not take prices as given. Thus imperfectly competitive markets are more likely to be the norm than perfectly competitive markets.

Consider the case where markets are monopolistically competitive. Countries will produce differentiated products. Because of increasing returns to scale, both the variety of goods and scale are constrained by national market-size. With trade opening up, the market potential is expanded. Each country can then specialize in the production of a smaller range or subset of products, while it imports those goods that it does not produce from other countries. The presence of increasing returns to scale thus permits mutually beneficial trade, even when the trading nations are similar in all respects. This implies that increasing returns to scale is an independent cause for international specialization, different from the case of HOS (Helpman and Krugman, 1985; 1989).

The presence of product differentiation and

economies of scale has some other implications, as stated in Salvatore (1998). First, the pattern of trade is not predictable from pre-trade pricing relationships. The opening of trade allows all countries the ability to take advantage of economies of scale to the same extent. Small or large countries could undersell each other given the open international market. Second, in contrast to HOS, where trade lowers the return to a nation's scarce factor, with intra-industry trade based on economies of scale it is possible for all factors of production to gain from trade. Third, the sharp increase in the internal trade in components within international corporations that seek to reduce production costs by producing various components in different countries may be related to intra-industry trade. Fourth, intra-industry trade is likely to be bigger among nations that are similar in size and relative factor endowments.

Another observation made by strategic trade theorists is that OLIGOPOLY dominates international trade (Root, 1993). This means that international firms have some control over decisions about where to produce, how to produce and pricing. Oligopolistic firms obtain monopoly profits because of entry barriers that keep new firms out of the industry. Internal economies of scale form an entry barrier. Internal economies of scale arise in the situation where the average cost of production declines as a result of increases in the firm's output. Due to these substantial economies of scale, world demand would support only a few firms in many industries. Strategic trade theory argues that countries may export certain products simply because they have a firm that was an early entrant into an industry that will support only a few firms because of economies of scale. This situation is sometimes referred to as 'first mover advantage'. The firm that manages to establish itself in the industry will capture monopoly profits that are difficult to be competed away. First mover advantage in the presence of substantial economies of scale provides an explanation of trade patterns that is different from the HOS model (Hill, 1999).

The pattern of trade can also be affected by external economies of scale, according to Root (1993). This is the situation where the average cost of production for all firms decreases as industry output expands. When the average cost of production declines as the cumulative output of the industry increases, because firms are accumulating knowledge over time, this is called 'dynamic external economies'. The nation where an industry is first established or grows larger could be the result of an accident of history. But once established, if the industry grows larger, the advantage over other countries becomes cumulative over time.

The presence of economies of scale and imperfect competition implies a role for government policy. Strategic trade policy is government policy aimed at improving the competitive position of a domestic industry or firm in the world market. A government can help raise national income if it can somehow ensure that the firms to gain first mover advantages are domestic rather than foreign enterprises. This could be done by a sophisticated and judicious use of SUBSIDIES to those industries. It might also pay for governments to intervene in an industry, if it helps domestic firms overcome the barriers to entry created by foreign firms that have already reaped first mover advantages.

Supporters of strategic trade theory sometimes offer another argument for protection. If the product market has increasing returns to scale, the expansion of output will lower the marginal costs of production. Under this scenario, a local producer whose domestic market is protected will expand output for the home market and, because of these economies, become a more effective competitor in international markets as well. Thus domestic protection actually might serve to promote exports.

Proponents of strategic trade policy use some prominent examples to make their case (Hill, 1999). It has been argued that the AIRBUS CONSORTIUM was able to break into the world market for commercial aircraft as a result of subsidies. A second example is from the Japanese semiconductor industry. It is claimed

that Japanese firms succeeded in gaining market-share in the industry from US firms because the Japanese government protected their domestic market while pursuing policies to ensure that Japanese firms got the necessary manufacturing and product know-how. The same can also be said for Boeing, where US government acquisition and research and development (R&D) policies are supposed to have given that firm advantages in the commercial aircraft market during the 1950s and 1960s (op. cit.).

Strategic trade policy is couched in terms of the capture of economic rents in imperfectly competitive markets. Government protective policies strengthen domestic firms against their foreign rivals. This enables them to capture economic rents from foreign oligopolists. The intervention of government thus makes it possible to shift economic rents from foreign to domestic firms, which increases national welfare. Root (1993) and Corden (1997) cover these arguments well.

Implementing strategic trade policy is fraught with problems. First, there is the difficulty of identifying strategic industries. It could be argued that strategic industries are industries with high growth potential and industries that are believed to generate significant positive EXTERNALITIES for other sectors or for society as a whole. The problem is that there is no reason to believe that the government is better at picking such industries than private capital markets.

Second, even if it is assumed that such industries can be identified, there are questions about the size and duration of the protection or subsidies that the government should accord them. This is important, since resources transferred to one sector of the economy are lost to other sectors. There are also income distribution consequences of these policies. The protection of domestic markets by tariffs or subsidies implies that domestic consumers are being taxed so that the strategic industries attain whatever advantage comes by learning. Even when the policy is supposed to capture rents through the domestic oligopoly, it is still a

transfer from domestic consumers to domestic producers.

Third, there is not yet enough careful empirical evidence to validate strategic trade policy. Many of the arguments are actually not new. Some of them resemble the infant industry arguments (see *INFANT-INDUSTRY PROTECTION*). The difference now is that they are buttressed with the same sophisticated tools of analysis that are used in mainstream international trade analysis.

See also:

new trade theory

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ALFRED N. NTOKO

Street, James H. (1915–88)

James Street's outstanding contributions include adapting the institutionalist approach of *VEBLEN* and *Ayres* to the context of developing economies, and the discovery and further development of theoretical links between the

institutionalist school and the Latin American structuralists. Although the institutionalist approach (see *INSTITUTIONALISM*) had previously developed through studies of Western industrialized economies, Street found it to be especially useful in the study of *LESS-DEVELOPED COUNTRIES* (LDCs). Thus he viewed the economy as an open system in which *TECHNOLOGICAL CHANGE* is the engine of development, with institutional factors steering the direction of change and often reducing its pace, sometimes to the point of stagnation. It followed, therefore, that debilitating institutions that were the centres of both international and domestic power were much more useful in explaining *UNDERDEVELOPMENT* than were relative prices. Indeed, one could not understand relative prices until these sources of social and political power were taken into account. Instead of tending towards a self-regulating market, an economy is seen as a social system in which technological and ceremonial behaviour interact, causing change to be an evolutionary phenomenon.

Street found the Latin American *STRUCTURALISM* approach to be especially strong in identifying the institutional factors that retard development (such as the *latifundio* land-tenure system), but lacking in effort to discern a motive force for promoting development. Apparently the structuralists assumed that if institutional roadblocks were removed, the investment incentives of the market would then be sufficient to provide the needed investment. It might be noted, however, that a similar criticism is sometimes levelled at institutionalists. Thus, some institutionalist writings have been said to imply that, as the institutional resistance to change is lessened, the 'natural' progress inherent in new technology will push the economy forward. Such criticism does not apply to Street, however. For him, there were strong roles for government in the area of technology policy and in the promotion of education. If appropriate technologies are to benefit all levels of society, it is necessary that government be vigilant with respect to foreign and domestic power groups (new groups as well as the established ones) and that it promote

structural adjustment programmes (SAPs)

appropriate education and disseminate it widely.

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WILLIAM E. COLE

structural adjustment programmes (SAPs)

'Structural adjustment' usually refers to the market-oriented policies supported by the WORLD BANK and INTERNATIONAL MONETARY FUND (IMF) which have been adopted in most developing countries since the early 1980s.

Adjustment policies dismantle the apparatus of state control built in many developing countries from the 1950s onwards. Programmes typically first address macro-economic issues. The EXCHANGE RATE is devalued, followed by transition to a market-based regime. Trade QUOTAS are replaced by TARIFFS and the level of these tariffs steadily reduced. Consumer and producer subsidies are reduced in the case of social services and removed for other goods and services. Government intervention in credit markets is eliminated and the autonomy of the central bank increased. As adjustment proceeds, institu-

tional issues are addressed (including public-sector reform and the PRIVATIZATION of state enterprises). The 1990s have witnessed 'second generation conditionality', as donors have added governance issues to the policy agenda.

The controversy surrounding adjustment programmes has raged around three main sets of issues: their purpose, design and impact.

A series of shocks in the global economy in the early 1980s precipitated economic crisis in many developing countries and paved the way for adjustment policies. The World Bank argues that countries needed to liberalize to allow the market to respond to changing world conditions. An alternative interpretation is that the Bretton Woods Institutions (BWIs) were primarily concerned to secure repayment of debt obligations for themselves and private creditors; hence adjustment programmes focus on increasing foreign exchange earnings and have an agreed schedule of debt payment as a central element. A third perspective sees the BWIs as agents of international CAPITALISM: the policies they advocate will wed developing countries more firmly to the global economic system and so facilitate their exploitation and continued low level of development.

Adjustment programmes operate through a system of *ex ante* conditionality: an agreement is signed by which the developing country will receive money (usually in tranches) in return for carrying out policy changes. In practice funds are often released despite many conditions being at most partially implemented: this is called 'slippage' (about 40 per cent of conditions are not implemented). Some critics, while sympathetic to the adjustment effort, argue that conditionality has failed. More fundamentally, others argue that conditionality is a violation of national sovereignty.

Methodological difficulties and the ambiguity of the data leave room for considerable disagreement as to the economic impact of adjustment policies. The World Bank claims that adjusting countries perform better than non-adjusting ones. However, others have found that there is no significant impact on growth and investment may well fall (on the other hand, it seems that exports respond

positively). Manufacturing firms, which previously enjoyed substantial protection, close, which some have dubbed DEINDUSTRIALIZATION (but it may reflect resource reallocation). Agricultural performance has remained poor in many adjusting countries and critics point to the supply constraints of poor infrastructure and the absence of rural credit, both of which may be exacerbated rather than alleviated by adjustment. It is usually the service sector that grows most rapidly with the advent of adjustment.

Many authors take it for granted that the adverse social effects of adjustment are proven. But this is not the case. As with economic impact, disagreements over method and the wide diversity of experience mean that no consensus has arisen. Moreover, there has been a discernible shift in the emphasis of World Bank programmes since the later 1980s to pay more attention to social issues, although not so far as to fully satisfy calls for 'adjustment with a human face'.

Policy conditionality should be expected to remain a feature of the aid scene for the foreseeable future, though with a continuing evolution of the content of policy dialogue.

See also:

stabilization policies; Washington consensus

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HOWARD WHITE

structural change

While macro-economics regards changes in the levels and rates of growth of aggregate economic activity, structural change deals with variations in the *composition* of economic activity and the effect such variation has on the operation of the economic system. Structural analysis thus often focuses on such factors as organizational and institutional evolution, changes in labour supply and the supply of natural resources, capital- and labour-displacing technological progress, and the composition of final demand. The importance of these factors for sectoral proportionality and balance means that structural analysis is often conducted at a slightly lower level of aggregation than most macro-economic models, highlighting (for example) inter-industry relations. The foreign sector is an important part of the analysis of structural change, as the size of the export sector, the composition of imports and exports, and a country's relative dependence on trade as a proportion of economic activity will have implications for employment, structural and technological change, and the composition of demand. Structural change may also be seen as changes in the *data* of economic theory and is therefore important for understanding the long-term development of the economic system. A nation's structural position in the global economy often has important implications for such development, as well as for human, social and environmental well-being generally.

Structural change was an important part of the work of the classical political economists and KARL MARX. While NEO-CLASSICAL ECONOMICS traditionally takes the 'whole natural, social, and technical environment' as given, for the classics and Marx 'the explanation of the order and changes of these data itself formed part of the theoretical work' (Lowe, 1954: 109).

structural change

The discussion by ADAM SMITH of the DIVISION OF LABOUR and its relation to capital accumulation, the analysis by DAVID RICARDO of labour-displacing technical change, and the requirements for inter-sectoral proportionality and balance exhibited in Marx's schemes of reproduction, are all examples of important contributions to the analysis of structural dynamics to be found in the major works of classical political economy. For Smith, the mutually reinforcing relation between economic growth and technical change is at the heart of the dynamics of a capitalist economy. Growth in markets for manufactured goods at home and abroad permits the development of the division of labour, leading to higher rates of labour productivity. ECONOMIES OF SCALE and dynamic increasing returns make Smith's system one in which positive feedbacks, rather than the negative feedbacks of EQUILIBRIUM MODELS, are dominant. Ricardo's addition of the chapter 'On machinery' to the third edition of his *Principles* conceded the possibility that labour displaced by technical progress might not be employed elsewhere, a point picked up and developed by Marx and incorporated into his analysis of growth and cycles. In Marx, capital accumulation increases the demand for labour, leading to higher wages that cut into profits. This leads capitalists to search for labour-displacing technologies that can restore profitability, furthering investment and thus another round of growth. Marx also outlined the requirements for proportionality and balance in his schemes of reproduction – with output in the capital goods sector replacing the fixed capital in both the capital and consumption goods sectors, and output in the consumption goods sector providing the means of subsistence for labourers in both sectors. Expanded reproduction thus requires not only aggregate but also inter-sectoral proportionality and balance. In all these authors, the foreign sector provides an outlet for the goods produced in domestic industries and is thus central to the development and dynamics of an economy's economic structure. International trade policy was also of great concern to the

classical economists, with Smith arguing against the mercantilists (see MERCANTILISM) but also anticipating something like an infant-industry hypothesis (see INFANT-INDUSTRY PROTECTION), and Ricardo debating with THOMAS MALTHUS over the CORN LAWS. Marx's analysis gave rise to a number of theories of imperialism, where colonial policies and the Atlantic slave trade played important roles in the rise and development of CAPITALISM.

Important frameworks for analysing structural change in the classical tradition have been developed by such authors as Pasinetti (1981) and Lowe (1976). The former's model is an example of the vertically integrated approach and the latter's an example of the horizontally integrated approach to the analysis of structural change. Vertical models focus on changes in the composition of final demand, while horizontal models focus on inter-industry relations. Pasinetti's model is made up of three sets of sectors: a capital goods sector, a final goods sector and a household sector. The capital goods sector produces capital goods used by itself and the final goods sector. The final goods sector produces commodities consumed by households. The household sector provides labour employed in the capital goods and final goods sectors, and consumes final goods. The model is thus useful for analysing the conditions necessary for maintaining full employment in the face of technological change and changes in the composition of final demand. Technical progress in the different sectors (which is assumed to take place at different rates) changes production coefficients and thus capital-labour ratios. Changes in labour productivity has an impact on real incomes, which increases both the size and composition of final demand (along the lines of ENGEL'S LAW). Productivity growth decreases, while higher levels of effective demand increase the demand for labour. These factors, along with population growing at a positive rate (including migration) resulting in increasing labour supply, mean that full employment is unlikely to be maintained without government intervention.

Unemployment as a normal feature of capitalism is also the result of Lowe's horizontal model. Lowe's three-sector model is comprised of two capital goods sectors and a consumption goods sector. Sector 1 produces capital goods employed in the capital goods producing sectors (itself and Sector 2). Sector 2 produces capital goods used in the consumption goods sector (Sector 3). Sector 3 produces consumption goods for labour employed in all three sectors. Lowe's model highlights, among other things, the structural conditions for steady growth and the traverse from one growth path to another. Assuming no technical change and the supply of labour growing at a rate exactly sufficient to utilize the means of production, the allocation of total output in Sector 1 between itself and Sector 2 will determine the path of economic growth. Should the table be turned and the question become that of maintaining full employment in the face of a change in the rate of growth of labour supply or labour-/capital-displacing technical change, a transformation in the structure of the real capital stock will be required. The clear result is that the primary obstacle to an economy running at full employment and full capacity utilization, when adapting to unexpected changes in the supply of labour or natural resources or technological change, is the inadequacy of the structure of its stock of real capital. 'The root of all these difficulties is *technological*' (Lowe, 1976: 9). For any one country, bottlenecks in the supply of capital goods or natural resources may be relieved through importing. This can occur through either direct importation of the needed goods or the importation of the goods needed to increase domestic production. Of course, such a solution is limited by a number of factors and is not available for the global system as a whole.

The international dimension of structural change can be viewed through Kaldor's model of cumulative causation. Kaldor (1985) weds the classical theory of competition, growth and technical change in Smith (and developed by Allyn Young) and Marx to the Harrod-Domar-inspired dynamic extension of Keynes'

principle of effective demand, and develops the implications for global competition and the balance of payments. Development of a nation's manufacturing sector as a whole leads to increasing productivity through external economies and increasing returns, which leads to price and non-price competitiveness in global markets. A positive cycle of cumulative causation is engendered as competitive success increases demand, which leads to another round of growth and productivity increases. Such success is reflected in a nation's balance of payments position. On the other hand, sluggish growth in a nation's manufacturing sector means slow rates of productivity increases and weakness in global markets, reflected in the balance of payments. This latter scenario is typical of those nations assigned the role of primary-product producers in the international division of labour. Specialization in primary production means low income elasticities of demand and leaves the scope for technical change in agriculture dependent on importing capital (see INCOME ELASTICITY OF DEMAND). Industrialized countries benefit from the internal dynamics of the manufacturing sector with high income elasticities of demand for its products and a scope for technical progress that feeds back into demand for dynamic industries, harkening back to Lowe's emphasis on the machine tools sector. The splitting up of the world into competitively successful manufacturing economies and sluggish primary-product producing economies was dubbed by Kaldor (1981) the 'polarisation process' and has important points of contact with the PREBISCH-SINGER HYPOTHESIS regarding the declining net barter TERMS OF TRADE for developing economies and the structuralist interpretation of the world economic system (see STRUCTURALISM).

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structural power

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MATHEW FORSTATER

structural power

'Structural power' is the authority to set the rules of the game and thus, without bringing about specific outcomes, it constrains possible outcomes to a limited set. It shapes what is plausible within social relations and what is deemed irrational or impossible. It is the ability to construct the common sense of international political economic relations and is complementary to analyses concerned with relational POWER (between actors relative to each other in a specific instance).

Steven Lukes (1974) identifies three dimensions in the analyses of power. One-dimensional perspectives focus on decisions where there is some explicit conflict of interest between actors in a specific set of relations. A distributional analysis of power reveals why one actor's interests, or goals, take precedence over another's. While able to recognize many of the resources that may be utilized to bring about specific ends, this approach requires the positive behaviour of power-holders to be identified.

In addition to positive action to bring about specific outcomes, two-dimensional perspectives on power also consider decisions which are prevented despite an observable conflict. A powerful actor may delay decisions (or obstruct the decision-making process for a particular issue altogether) to support the continuity of the status quo. This is the power to ignore those who are opposed to the current settle-

ment within a particular set of relations where the settlement benefits the power-holding actor. In both dimensions, power is only recognized within a particular relationship between actors and is characterized as positive action of some sort.

Lukes suggests that a three-dimensional perspective is required to produce a comprehensive analysis of power. The third dimension considers how potential issues are kept out of politics altogether. Power in this dimension obscures or hides conflict, though potential conflicts will still exist:

This potential, however, may never be actualised. What one may have here is a latent conflict, which consists of a contradiction between the interests of those exercising power and the real interests of those they exclude.

(Lukes, 1974: 24)

In this third dimension, the manipulation of knowledge of the possibility (or actuality) of conflicts becomes an additional and important site of power. By controlling the agenda of possible outcomes to be considered, the decision-making process itself may be presented as open and equitable. Unpalatable or unacceptable solutions for the dominant actor(s) never reach the agenda for consideration by others. This agenda is not necessarily a formal listing of alternatives, but can be conceptualized as actors' perceived alternatives in any specific situation. Lukes argues that only by considering this dimension as well can a full understanding of power be proposed.

In international political economy (IPE), the recognition of the importance of structural power is often attributed to SUSAN STRANGE. Strange suggests structural power governs the bargains struck in specific circumstances between authority and markets. The power to limit the agenda of choices in any particular political economic relationship may belong to one of the contending actors or be sited outside those relations, but it cannot be ignored in either case. This issue is central to Strange's

critique of mainstream IPE, which she suggests only ever recognizes relational power issues.

Strange argues there are two aspects that make up structural power. The first (which has been partly explored in *REGIME THEORY*) is how the norms, principles, rules and decision-making procedures are set in any particular political economic *ISSUE AREA*. However, the second aspect of structural power is much more wide-ranging and encompasses the first:

Structural power, in short, confers the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises. The relative power of each party in a relationship is more, or less, if one party is also determining the surrounding structure of the relationship.

(Strange, 1988: 24–5)

Strange proposes that the distinction between relational power and structural power should replace the problematic distinction between economic and political power. She seeks to establish the centrality of a general analysis of structural power in the international political economy, predicated on the inseparability of politics and economics.

One of the main difficulties with recognizing and analysing structural power is the need for a form of counterfactual argument. If structural power is influencing and shaping the possibilities for political economic action, then other possibilities have been ignored or obscured. If the partiality of the agenda is not apparent to the actors within these political economic relations, an analysis of structural power requires an account of their real interests: the analyst must suggest why their interests are not as they appear.

To identify any group's real interests, analysis must propose a social structure which is the key to these interests and from which the real conflicts can be deduced. If this structure is not immediately visible, its recognition assumes that structural power is incomplete, otherwise the underlying structure would remain obscured. Thus, in an analysis of structural

power, the infallibility of power is central. Normatively, structural power analyses suggest that the values conditioning political economic relations are not formed within these relations, but are external to them and reflect the interests of the powerful. This implicitly denies the efficacy of *POSITIVISM* in social science and links structural power analyses with the epistemological issues of *CRITICAL THEORY*.

The identification of structural power, in recognizing more than positive action within power relations, also moves away from requiring intent on behalf of the powerful. Agendas may be shaped without the explicit intention of obscuring conflict or the recognition that choices are being constricted in the interests of powerful actors. However, if unintentional outcomes are included under the rubric of power, then the use of the concept may become a substitute for a meaningful explanation. This highlights the need for a multifaceted concept of power (including both relational and structural elements) to recognize the different elements of power that produce different levels of effect simultaneously.

If structural power influences the knowledge of conflict, then what balance can be drawn between structure and agency? While there is a need to recognize the structures within which power relations operate, if these structures were fully deterministic then there would be no basis for recognizing relational power, as structural power would bring about all effects or outcomes. Again, this re-emphasizes the need to retain a relational element to any structural analysis. IPE analyses need to recognize both relational and structural power.

Therefore, without understanding structural power we cannot fully understand how relational conflicts are resolved and how the actors' agendas are set or changed within the international political economy. But this is not to suggest that an analysis of structural power should preclude or replace conceptions of relational power. Though the lack of theoretical and analytical recognition of structural power has been a major problem for the mainstream of IPE, this is not to argue that a structural analysis on its own would be any

structural realism

more useful than a relational analysis that failed to include structural elements in its argument.

See also:

knowledge structure; neo-Gramscianism; structuralism

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CHRISTOPHER MAY

structural realism

The term 'structural realism' is used by some as a synonym for NEO-REALISM. Others use it to identify a more open approach that starts from Waltz's neo-realist theory, but diverges from it in a number of significant ways. Neo-realism is

a theory of international *politics*; structural realism attempts to embrace the economic and societal sectors as well, aiming for a more broadly based theory of international *relations*.

Structural realism accepts the primacy of the political in the realist tradition on the grounds that, while economic structure is contingent (that is, markets are dependent on political structure), political structure is foundational. But it does not see ANARCHY as either ineradicable or universal, nor politics as necessarily superior to (or determinative of) dynamics in other sectors of human interaction. It accepts the primacy of the state as the most important defining unit of the international system (although not excluding other units from the theory) and is conscious that states can take many forms. Structural realism makes a feature of the theory of the state that is implicit but dormant in neo-realist thinking. It also accepts Waltz's basic definitional framework for international system structure as rooted in the arrangement of the units, but it applies this framework well beyond the confines of the political sector. Because of its multisectoral approach, structural realism rejects neo-realism's aggregated view of power and argues that more is gained than lost analytically by differentiating power in terms of sectors.

Structural realism rejects Waltz's conflation of levels of analysis with sources of explanation and, therefore, his treatment of system and structure as synonymous. It posits 'interaction capacity' as a major source of explanation at the system level that determines how (and indeed whether) structure operates to shape the form and behaviour of units. Interaction capacity is the amount of transportation, communication and organizational capability within the unit or system: How much in the way of goods and information can be moved over what distances at what speeds and at what costs? It is about the technological capabilities, and the shared norms and institutions, on which the type and intensity of interaction between units in a system (or within units) depends. It refers to the carrying capacity of a social system, its physical potential for enabling

the units within it to exchange information, goods or blows. Interaction capacity shapes not only how big a system can be, but also what its units will look like and in which sector(s) the dominant forms of interaction will take place.

Structural realism also rejects neo-realism's ahistorical assumptions about the nature and evolution of international systems. One of its objectives is to open up, rather than taking for granted, the question of what are the necessary and sufficient conditions to say that an international system exists, and to explore that question from a world historical perspective.

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BARRY BUZAN

structural violence

The term 'structural violence' was coined by the Norwegian peace researcher JOHAN GALTUNG. He differentiated between 'direct' and 'structural' violence, where direct violence is defined as physical violence, which is concrete and visible. Direct, physical violence results in people being somatically hurt or even killed. Violence as such is at hand when human beings

are affected in such a way that their factual bodily and mental status is lower than it could have been. This means that when the potential of someone is higher than the actual status/situation of that person and the actual situation is avoidable, then violence exists (Galtung, 1969).

Structural or indirect violence, as opposed to direct violence, is built into the relation between two or more parties. There is no directly visible actor who exercises violence. Further, structural violence must not be intentional. That is, it is not necessarily the case that someone intends to cause harm. In addition, structural violence must not have a specific object or target – it is not directed against anyone in particular. Rather, its effects are arbitrary. Nevertheless, the result is the same as in Galtung's initial definition of violence.

Some degree of structural violence exists in all societies. Inequality in the form of distribution of economic and political resources is seen as the basic formula behind structural violence. However, the existence of structural violence depends on whether the outcome of structural inequalities is possible to avoid. When people suffer from poverty and resources exist to change unequal structures, then structural violence is at hand. Galtung's classic example is that if a person died from tuberculosis in the eighteenth century, it could not be defined as violence since it might not have been avoidable. However, dying from tuberculosis in the twenty-first century would be an outcome of violence, since it is clearly avoidable. However, not all inequalities are caused by structural violence, only those inequalities that stem from an asymmetrical relationship between groups or actors. For many structuralists, stratification in the international system is an example of structural violence (Galtung, 1971; Wallerstein, 1974). Examples of structural violence could be exploitation, marginalization and fragmentation. Mechanisms of structural violence are related to functions and characteristics of structures, in the form of rank and interaction.

Some (for example, Ehrlich and Ehrlich, 1972) have argued that the effects of structural violence far outnumber the effects of direct

structuralism

violence, implying that structural violence leads to enormous human suffering.

Galtung's motivation for the differentiation between physical and structural violence is that, if peace is only to be defined as the absence of physical and direct violence, an unacceptable social order would be compatible with peace (Galtung, 1969: 168) – a situation which from the normative perspective of peace research could not be accepted. Peace should rather be seen in positive, constructive terms.

Johan Galtung is also the founding father of the conceptual pair: 'positive' and 'negative' peace. Negative peace is at hand when there is an absence of direct and physical violence, while positive peace only exists when there is an absence of both direct and structural violence.

The terminology has had a great impact on debates within peace and conflict research. The conceptualization has also been criticized. One critique has to do with the difficulties in determining whether structural violence is actually at hand. A second but related point of criticism has to do with the risk of ideologizing violence. Since structural violence is not assessed as violence by actors involved, there is a risk that researchers impose their own values on the actors and the situation. Third, if structural violence of some sort exists in all societies, then true positive peace can never be achieved.

In recent years, Johan Galtung has added a third concept of violence ('cultural' violence) to the other two. By cultural violence is meant aspects of culture which may be used to justify or legitimize direct or structural violence (Galtung, 1990). Thus cultural violence is to be seen as legitimizing ideological or discursive systems.

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HELENA LINDHOLM SCHULZ

structuralism

The term 'structuralism' is widely used in such disciplines as anthropology, development economics, cultural studies, linguistics and psychology, albeit with different meanings. A structuralist perspective within INTERNATIONAL POLITICAL ECONOMY (IPE) is gaining recognition, as evidenced by the work of R.J. Barry Jones (1995) who compares structuralism with liberal, Marxist, economic realist and institutional perspectives (see LIBERALISM; MARXISM–LENINISM; REALISM; INSTITUTIONALISM). Aukie Hoogvelt (1997) in turn distinguishes three perspectives within IPE, namely realism, institutionalism and structuralism. In her view, ROBERT COX (1981) is a key contributor to the structuralist perspective in the field through his development of an 'historical structure' analytical framework which contests the assumption that countries constitute independent units, as their development can only be understood through their systemic linkages. SUSAN STRANGE (1988), a well-known scholar in international studies, develops a power-focused view of structuralism in the international political economy. She distinguishes several interacting power structures in the WORLD ECONOMY, none of which is dominant on its own. This gives her particular structuralist perspective a multidimensional and non-deterministic character. A more recent attempt to link structuralism to IPE has been made by Björn Hettne (1995). He argues that development theory and IPE are complementary and should be merged into a single discipline known as the international political economy of development.

Structuralism largely evolved from the interaction between development economists in Europe and Latin America. Pioneers in devel-

opment economics, such as Paul Rosenstein-Rodan, PAUL BARAN, GUNNAR MYRDAL, ARTHUR LEWIS and HANS SINGER, and later writers including Dudley Seers, Nicholas Kaldor, Thomas Balogh, Paul Streeten and Hollis Chenery among others, influenced the Latin American structuralist school and were in turn influenced by it. The Latin American structuralist school largely emanated from the UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA (ECLA) under the leadership of RAUL PREBISCH. Other key contributors to the structuralist paradigm include Aldo Ferrer, Celso Furtado, Aníbal Pinto and Osvaldo Sunkel. A significant number of European structuralists, who resided mainly in England, were of Central European origin, mostly from the agrarian and less-developed Eastern European countries. This may explain why they favoured industrialization and protectionism, having been influenced by the INFANT-INDUSTRY PROTECTION argument of the German political economist FRIEDRICH LIST and having observed at close range the rapid industrial development of Germany as a result of protectionist policies and strong state intervention.

The most comprehensive attempt to develop a structuralist position in development economics was made by the Latin American structuralists. It can be argued that the essential antithesis in development economics is between neo-classical and structuralist theories. Structuralists perceive the economy in LESS-DEVELOPED COUNTRIES (LDCs) as being inflexible and as confronting major constraints or structural barriers. They distrust the price mechanism and justify government intervention in the economy as accelerating the process of economic development and structural transformation. Above all they regard the distinct asymmetries in international political economic structures and relations as having a detrimental impact on LDCs. By contrast, the neo-classical position emphasizes flexibility in which prices rule and government intervention or *dirigisme* is spurned. They hold a benign view of international economic trade and investment relations. Following the rise of

NEO-LIBERALISM and the CHICAGO SCHOOL in the 1970s and 1980s, it has become more common to refer to the neo-classical position as neo-liberalism.

Characteristics and originality of structuralism

The key propositions of structuralism concern the WORLD MARKET ECONOMY and UNEQUAL EXCHANGE as formulated in the CORE-PERIPHERY MODEL of the late 1940s and early 1950s. The originality of the structuralist model lies in its central proposition that development and underdevelopment constitute a single process, so that centre and periphery form one world economy. Furthermore, the disparities between the centre and periphery are reproduced through international trade. Thus the periphery's development problems are located within the context of the international political economic system.

This analysis of the world economic system directly challenged prevailing orthodox theories and continues to generate controversy. The argument that the centre and periphery countries are linked in a series of asymmetric relationships which reproduce the international political economic structures represented a radical break with evolutionist and mechanical stage theories of development. Modernization and stage theories, such as that of W.W. ROSTOW, maintain that all developed countries (DCs) were once underdeveloped and that present-day underdeveloped countries can evolve into DCs by following similar policies and stages to those pursued by the capitalist DCs. Structuralists consider such theories to be ahistorical or unhistorical, as they do not take into account the different origins, structures and dynamism of the peripheral economy, nor the changing nature of the world-system.

Structuralism thus grew out of a profound critique of NEO-CLASSICAL ECONOMICS which was seen to contribute little to an understanding of the development problems of the periphery or LDCs. In its place, the structuralist group (centred in ECLA) aimed at constructing an alternative autochthonous

structuralism

analysis, one which identified the major obstacles to development in Latin America and proposed remedial policies. Among the numerous contributors to the structuralist paradigm, Prebisch's ideas were pivotal and his pioneering book (published in 1950) was praised by ALBERT O. HIRSCHMAN (1961) as 'ECLA's manifesto'. Prebisch's view of the international economic system as comprising an industrial centre and an agrarian periphery, in which the former dominates and exploits the latter, has been enormously influential in the analysis of UNDERDEVELOPMENT – as seen in the theory of unequal exchange developed by Arghiri Emmanuel and in DEPENDENCY THEORY and WORLD-SYSTEMS THEORY (see also FRANK, ANDRE GUNDER; WALLERSTEIN, IMMANUEL). Prebisch also played a major role in setting up the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), becoming its first Secretary-General from 1964 to 1969.

Structuralism is both a holistic and historical perspective. It probes into the origins of the integration from colonial times of THIRD WORLD economies into the dominant capitalist system as producers of agricultural and mineral primary commodities. Structuralists term this pattern of development in the periphery the 'primary-export model' or the 'outward-oriented development model', to distinguish it from the industrial-export and AUTONOMOUS DEVELOPMENT model of the centre countries.

The structuralist approach is not narrowly economic, as it emphasizes the part played by institutional and social factors in the functioning of an economy and particularly the role of the state as a key agent in the development process. Structuralism and the institutional approach in economics have thereby certain affinities and have benefited from their mutual influence (see STREET, JAMES H.). The analysis of the external impact of the centre countries on the periphery, such as the impact of COLONIALISM, the GREAT DEPRESSION, World War II and GLOBALIZATION, and the internal transformations which these brought about are of particular significance to structuralists.

Structuralism was influenced by KEYNESIAN ECONOMICS in its advocacy of major increases in government expenditure for development purposes. However, it went further than Keynesianism in regarding the state as the crucial agent for economic, social and political change (see also DEVELOPMENTAL STATE). Through economic planning and protectionism, the state was seen to spearhead the industrialization process in developing countries. Structuralists influenced government policy in many developing countries between the 1950s and the 1970s, providing arguments in favour of LAND REFORM and STATE-OWNED ENTERPRISES (SOEs). Its ideology was anti-feudal, anti-oligarchical, democratic, reformist and technocratic. It questioned the perverse effect of capitalism in the periphery and the resulting inequities in the institutional economic arrangements. While it promoted structural change, it did not advocate revolution, DE-LINKING or SOCIALISM.

Features of the centre and the periphery

According to the structuralist paradigm, the key features of the centre and the periphery emerged with the industrial revolution and the growing linkages forged between them by the new international political economy. This increased the productivity of the factors of production dramatically, but the diffusion of technical progress was very uneven throughout the world. The centre countries internalized the new technology by developing an industrial capital-goods sector and employing more advanced technology across economic sectors. This resulted in the development of an homogeneous and integrated economy. In the periphery, by contrast, new technologies were largely imported and mainly confined to the primary-commodity-producing export sector. The industrial sector was insignificant and the capital-goods sector rudimentary or non-existent. As a consequence, the peripheral economy became both disarticulated and dualist: disarticulated because it had to import advanced technology from the centre and dualist because of the large productivity gap

which existed between the export and subsistence sectors.

The periphery is characterized as having a sizeable low-productivity pre-capitalist sector which continuously produces a large surplus of labour. This surplus labour keeps wages low and prevents the periphery from retaining the fruits of its own technological progress, productivity increases in the export sector being largely transferred to the centre through a deterioration of the *TERMS OF TRADE*. Thus, in the structuralist view, international trade both perpetuates and deepens the asymmetry between centre and periphery.

Unequal terms of trade

The terms of trade analysis demonstrates ECLA's distinctive approach to the problems of development and underdevelopment. The structuralist thesis on the secular deterioration of the periphery's terms of trade has generated much controversy. It challenged the orthodox theory of international trade and questioned the international division of labour (see *DIVISION OF LABOUR, INTERNATIONAL*). As such, it was strongly criticized by neo-classical economists such as JACOB VINER. Contrary to the predictions of conventional trade theory, Prebisch found that the periphery's commodity or net barter terms of trade – that is, the relationship between the price index of the periphery's exports to the centre countries and the price index of its imports from the centre countries – had turned against the periphery since the 1870s. Although these terms of trade fluctuate continuously, the long-term trend was clearly unfavourable to the periphery. This meant that the periphery had to export an increasing quantity of raw materials in order to import the same amount of industrial commodities. As Hans Singer came to a similar conclusion at the same time, the thesis on the deterioration of the terms of trade is known in the economic literature as the *PREBISCH-SINGER HYPOTHESIS*.

Prebisch's analysis of the deterioration of the terms of trade deals with both demand and supply conditions of commodity markets. On

the demand side, the terms of trade deteriorated against the periphery because of the different *INCOME ELASTICITY OF DEMAND* for imports by the centre and periphery or, as Prebisch puts it, because of the 'dynamic disparity of demand' between centre and periphery. This means that imports of primary products by the centre from the periphery rise at a lower rate than its national income. Meanwhile, imports of industrial commodities by the periphery from the centre grow at a faster rate than its income. The low income elasticity of demand at the centre, which is well below unity, is explained by various factors. As income increases, a smaller proportion is spent on food (*ENGEL'S LAW*), technical progress develops new ways of producing commodities requiring fewer raw materials or substituting synthetic for natural products, and protectionist policies pursued by centre countries restrict the market for exports from the periphery. In the periphery, by contrast, the income elasticity of demand for imports is generally high (well above unity) as they mainly import industrial products, the demand for which rises proportionally more than income.

With respect to the supply arguments, or the 'cycle version' of the periphery's deterioration of the terms of trade, these are characteristically structuralist and are related to the differential effect of the world economic cycle on centre and periphery. The capitalist economic system evolves in a cyclical fashion with the centre being the initiator of these cycles, which provoke an adaptive cyclical response by the periphery. During an economic upswing, the terms of trade generally turn in favour of primary producers, but during a downswing they turn against them to an even greater degree. This results in the long-run deterioration of the periphery's terms of trade, especially as the downswings tend to last longer than the upswings.

This differential impact of the world economic cycle on centre and periphery is explained by the differential behaviour of prices, profits and wages in the centre and periphery during the phases of the cycle. During an economic upswing, wages grow

substantially in the centre but hardly rise in the periphery (given the availability of surplus labour). In a downswing, the fall in wages and prices in the centre is limited by trade union power and the oligopolistic structure of industry; by contrast, the downswing greatly reduces prices and wages in the periphery, as producers are able to compress wages substantially on account of the availability of surplus labour and the absence or weakness of trade unions. Thus, while workers and capitalists in the centre are able to gain the fruits of their technical progress through higher wages and profits, the opposite holds true for the periphery. For structuralists, the greater scope for productivity-increases in industrial production and the maldistribution of gains from trade explain the rising gap in incomes between centre and periphery. As Singer expressed it, the centre countries enjoyed the best of both worlds, retaining both the fruits of their own technical progress and capturing part of the underdeveloped countries' productivity increase. By contrast, the periphery suffered the worst of both worlds.

Although the periphery's terms of trade might deteriorate, this does not necessarily mean that it is unable to reap any gains from trade. What it does mean is that any gains resulting from international trade are distributed unequally between centre and periphery. In condemning the deterioration of the commodity terms of trade, structuralists are not arguing against international trade, nor have they ever suggested delinking. On the contrary, structuralists see international trade and foreign capital as essential elements for raising productivity and growth in the periphery.

In short, structuralists argued that the unequal terms of trade were not the only cause of the periphery's poverty, but they did reduce the economic surplus available to relieve it. This export-led growth of the periphery, known as the 'outward-looking' development model, retains its dynamism so long as export earnings grow fast enough to sustain an adequate rate of growth in the economy. The world depression of the 1930s dealt a major blow to exports and had severe internal consequences for income

and employment. To overcome the constraining effects of this outward-oriented process, ECLA proposed an 'inward-oriented' development model for the periphery, whose centre-piece was IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI).

The inward-oriented development model

Structuralists expected an ISI strategy to transform industry into the most dynamic sector of the periphery's economy and to lead to a higher rate of economic growth than could be achieved by continuing with the primary-export strategy. It was hoped that this substitution process would lead to two types of structural transformation in the periphery: changes in the structure of production as industry's share of national income increased, and changes in the volume and composition of imports.

Such an ISI policy was to be implemented by a variety of means, such as easy credit, infrastructure support and favourable foreign-exchange measures, but chiefly through protectionist measures such as **TARIFFS** and **QUOTAS**. This advocacy of protectionism ran counter to the dominant orthodoxy and principle of **COMPARATIVE ADVANTAGE** as it was understood at the time. It was believed that industrialization would prevent a repetition of the disastrous effects of the 1930s world crisis, that it would lead to greater increases in productivity and incomes, and that it would reduce unemployment and the surplus labour, thereby removing one of the causes of low wages in the periphery. In addition, it would help the retention of productivity increases in the periphery, avoid further deterioration of its commodity terms of trade and reduce the economy's external vulnerability.

For structuralists, industrialization is justified in the periphery even where the cost of production of local industry is higher than the international price, as otherwise some factors of production would remain unemployed or would be used to produce export commodities with further adverse consequences for the terms of trade. The relevant comparison is

not between industrial costs and import prices but between the increase in incomes obtained by employing the factors of production in industry and their alternative employment in the export sector. This is the key criterion for determining the type and degree of industrialization in the periphery. Once this has been established, a corresponding protectionist policy must be implemented to allow for the establishment, survival and growth of the chosen industries. Protectionism is required so long as the productivity of the periphery's industry falls below that of the centre countries and so long as this productivity differential is not compensated for by wage differentials. However, excessive protectionism has to be avoided as this would discourage agricultural production and weaken industrial efficiency.

Structuralists were initially optimistic about the benefits that industrialization would bring to the periphery. It was regarded as a way of overcoming the limitations of the outward-directed development process and of bringing social and political benefits, such as a strengthening of the middle and working classes and of democracy. Notwithstanding, one of the first criticisms of ISI came from within the ECLA fold itself. By the early 1960s, there was talk of an 'exhaustion' of the ISI process and an acknowledgement that the inward-directed development strategy had not led to a diversification of exports as anticipated. Indeed, despite substitution, the external bottleneck became even more problematic as the volume of imports continued to increase rapidly. Furthermore, a shift in the composition of imports to raw materials, spare parts and capital goods made them more, not less, crucial for sustaining industrial growth. In order to cover the resulting chronic deficit in foreign exchange, Latin American countries had continually to increase their foreign debt, the servicing of which became a major economic burden.

Structuralists therefore came to realize that industrialization could not remain enclosed within the national boundaries if the continuing shortage of foreign exchange was to be resolved. They vigorously promoted the idea of

regional ECONOMIC INTEGRATION, such as the setting up of a Latin American common market. It was hoped that the formation of the LATIN AMERICAN FREE TRADE ASSOCIATION (LAFTA) with its larger market would increase exports and encourage greater industrial efficiency by taking advantage of ECONOMIES OF SCALE. REGIONALISM was also regarded as strengthening the bargaining power of the periphery with regards to the centre. In order to ameliorate the new external vulnerability created by ISI, structuralists had already proposed in the early 1960s that industrial exports should be stimulated with special subsidies. By then it had become evident that the small size of the internal market and the exaggerated and indiscriminate protection of local industry had resulted in an inefficient monopolistic or oligopolistic industrial structure.

Structuralists further argued that industrialization was impaired by governmental delays in carrying out structural and institutional reforms, such as land and tax reforms. The unequal land-tenure system was seen as hampering agricultural productivity and growth as well as skewing the distribution of income. The stagnation of the agricultural sector limited industrial development, not only because agriculture failed to provide sufficient cheap raw materials and foodstuffs for the internal market, but also because the low purchasing power of the rural population limited the internal market for industrial commodities.

The ISI development process was also characterized by structuralists as having become both concentrating and excluding. By this it is meant that the fruits of technological progress brought about by industrialization were concentrated in the hands of the owners of capital, excluding the majority and aggravating inequalities in the distribution of income. Furthermore, this model resulted in 'structural heterogeneity' as differences between economic sectors (such as those between a backward agriculture and a modern capital-intensive industry) and those within economic sectors (such as those between the INFORMAL

structuralism

ECONOMY and the 'formal' economy) were exacerbated.

Structuralism versus monetarism

Further insights into the structuralist paradigm and method of analysis can be gained by examining the structuralist analysis of INFLATION. From the mid-1950s, a group of largely Latin American structuralists challenged conventional wisdom on the nature of and cures for inflation. This gave rise to a protracted debate between monetarists and structuralists (see MONETARISM), at the heart of which lay different economic philosophies.

Structuralists give much more weight to the social and political origins of economic events than monetarists. They also place greater emphasis on the state as a key agent in promoting economic development and in overcoming the deficiencies of the market. For structuralists, the removal of the main obstacles to development requires structural reforms of a social and political, as well as an economic, kind. While structuralists favour an inward-oriented and, to some extent, a self-reliant development strategy, monetarists advocate an outward-oriented development strategy that places greater reliance on the international market. Important political differences also exist: structuralists are considered to be broadly on the left, while monetarists are seen to be on the right.

With respect to inflation, structuralists situate the problem of inflation within the context of the structural transformation of the THIRD WORLD, while monetarists are less likely to do so. For structuralists, inflation also arises from the socio-political tensions, sectoral imbalances and expectations generated by the process of development. By contrast, monetarists regard the inflationary process itself as the major obstacle to growth. The principal difference arises over the causes of inflation: for monetarists inflation is a monetary phenomenon arising from excessive demand (too much money chasing too few goods), while for structuralists inflation arises from structural

maladjustments and rigidities in the economic system.

As a consequence of this debate, monetarists began to acknowledge the importance of structural factors, but turned the structuralist argument on its head by arguing that the supply rigidities arise from the distortions which inflation creates in the price and market system. Meanwhile, structuralists began to recognize that excessive and persistent inflation can jeopardize the desired structural transformations and development objectives, thereby requiring tighter fiscal and monetary measures to control it. Thus neither monetarist nor structuralist explanations are adequate by themselves and it is necessary to draw on both to explain and control inflation.

The neo-liberal counter-revolution and neo-structuralism

While structuralists were on the offensive in the 1950s and 1960s, the resurgence of neo-classical theory in the 1970s and 1980s turned the tables. Deepak Lal's fierce neo-liberal critique of structuralism and the 'poverty of development economics' (Lal, 1983) was countered by John Toye's structuralist critique of 'the counter-revolution' in development economics (Toye, 1993). In the ensuing debate, a neo-structuralist position began to emerge while, in turn, neo-liberals were influenced by structuralist ideas (although in ways not always intended by the contenders).

Turning first to developments in neo-liberalism, neo-liberals were influential in designing STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) which the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK recommended to governments in LDCs as a means of tackling the DEBT CRISIS. Their adoption of the term 'structural' could be taken to mean that neo-classical and neo-liberal adherents of SAPs have become structuralists of a sort. However, while the World Bank 'neo-liberal structuralists' have come to recognize the importance of structural factors in development, the reforms they advocate point in the opposite direction to those

proposed by structuralists. The neo-liberal structural changes entail rolling back the WELFARE STATE by radically reducing government expenditure (especially WELFARE expenditure), privatizing state enterprises, eliminating subsidies and protectionism, liberalizing markets, and switching from inward-oriented to outward-oriented development strategies so as to integrate LDCs even further into the world market. This paramount belief in the market mechanism clearly distinguishes neo-liberal structuralists from structuralism as understood here.

A second development in the 1980s concerns the espousal of a neo-liberal vision of a NEW WORLD ORDER in contrast to the NEW INTERNATIONAL ECONOMIC ORDER (NIEO) proposed by Prebisch and UNCTAD in the late 1960s and 1970s. Following Prebisch's structuralist analysis of a deterioration of the terms of trade, and the establishment of UNCTAD, the idea of reforming international trade and creating an NIEO took hold. But this NIEO never came about and UNCTAD's influence greatly declined during the neo-liberal 1980s. The neo-liberal world order promoted by the international financial institutions, the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries and the United States in particular, espouses EXPORT-LED GROWTH and EXPORT-ORIENTED INDUSTRIALIZATION (EOI), regarding these as superior to inward-oriented and ISI development policies.

A third development concerns the respective roles of the state and the market in development. Neo-structuralists have revised structuralism's earlier benign view of the state as rational, progressive and acting in the national interest with a more realistic view. While still favouring state intervention, neo-structuralists aim to 'get the balance right' between state and market (instead of just 'getting the prices right' as in the case of the neo-liberals). Neo-structuralists seek to stimulate a positive and dynamic interaction between state and market. Thus neo-structuralists have adopted a more 'market-friendly' position than 'orthodox structuralists' and have sought to remedy the lack of political analyses of the state.

Neo-liberals, by contrast, remain hostile to the state and trade unions, advocating PRIVATIZATION, LIBERALIZATION, DEREGULATION of the labour market and an ENTERPRISE CULTURE through private entrepreneurship. The state is seen as the source of most of the development problems in the LDCs. State interventionism or STATISM is said to have created distortions in the price mechanisms, which have resulted in the misallocation of productive resources and therefore lower rates of growth. The neo-liberal slogan is that, in an imperfect world, imperfect markets work far better than imperfect governments and planning.

A fourth development concerns the industrialization process in LDCs. Compared to the neo-classicals' earlier view that the LDCs' natural comparative advantage lay in the production and export of agricultural and mineral primary products, neo-liberals now contemplate the industrialization of some Third World countries. But the form of industrialization envisaged is of an export-oriented kind, being part of an export-led growth strategy. Undoubtedly the success of the South-East Asian NEWLY INDUSTRIALIZED COUNTRIES (NICs) played a part in changing their minds. However, the neo-liberals' explanation of the NICs' success as emanating from laissez-faire, the rejection of state intervention and an exclusively outward-oriented development policy has been fiercely contested.

Structuralists have also developed in their thinking. Although the neo-structuralists continue to favour 'development from within', they now more openly advocate the promotion of exports, particularly of industrial exports, and demand an end to the DCs' protectionism against the LDCs' exports. In this sense, the neo-structuralists are no longer trade pessimists. Rather they see the problem of industrialization as one of finding the right mix and sequencing of ISI and EOI.

To conclude, structuralism arose out of a critique of orthodox economic theory and, in particular, neo-classical theory. From the 1950s to the early 1970s, the structuralist paradigm exerted a major influence on Third World

governments. Although eclipsed in the 1970s and 1980s by the resurgence of neo-classical theory and neo-liberalism, structuralists remain unconvinced that neo-liberalism has the answer to the development problems of the Third World. The income gap between the North and the South has continued to widen, especially during the 'debt-ridden' decade of the 1980s. Only a few NICs have reduced the enormous gap in incomes with the DCs and they remain the exception that proves the rule. The NICs do not herald either 'the end of the Third World' or 'the disintegration of the Third World'. Furthermore, the essentially unequal nature of the world system continues to be reproduced. In this sense, structuralism has not been superseded, although it did not always get things right. Despite the neo-liberal critique, structuralism provides penetrating insights into the world economy, on which it is possible to build.

See also:

semi-periphery; structural change; Washington consensus; world-systems theory

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CRISTÓBAL KAY

structuration

One of the primary foundations of structuration theory is the work of sociologist Anthony Giddens. Giddens (1981) argued against the structural determinism of conventional Marxist analysis and the individual voluntarism in

many strands of liberal theories (see LIBERALISM; MARXISM–LENINISM). The first reduced individual actions to epiphenomena of underlying structural conditions, which might even be hidden to the actors themselves. Individuals were considered to operate under false consciousness, incognizant of the deeper conditions that constrained and influenced their behaviour. Liberal theory, by contrast, paid insufficient attention to the constraints and opportunities which confronted individuals in particular historical settings. Individual actions and the aggregate effect of such outcomes could be fully understood by analysis of preferences and resulting behaviour. In Marxism, history was all reducible to structure; in liberalism, history was all agent-driven.

By contrast, Giddens argues, agents operate in structures which are often not of their own making, but they are not historical dupes. Agents in every structure have some latitude to choose alternative paths or policies. Such choices, while intelligible within an existing script, are not *a priori* predictable. Moreover, the very structure in which individual agents operate is itself continuously subject to reinterpretation and alteration. The aggregate effect of such behaviour constrains and influences agents' subsequent options and choices.

The structurationist view has had two main effects on the study of international relations (IR). In political economy, it has led to a move away from Marxist structuralist analysis (see STRUCTURALISM), as well as to a re-examination of how states and social actors create international economic patterns and configurations.

Structuration theory has also led to a critique of the neo-realist paradigm in IR. Neo-realism essentially posits the primacy of structure. Due to the ANARCHY of the international system, states (the agents in the international system) must necessarily rely on self-help and focus on their own survival. From a structurationist viewpoint, this privileges the international system and its architecture at the expense of individual state choice. That is, policies are fully understood as the inevitable

sub-Saharan Africa (SSA)

results of structure, while that structure itself is not drawn into doubt. The ontological view of neo-realism is premised on the notion of discretely separated elements without any examination of how such a structure arose or how such a structure might be altered.

Structurationists have therefore argued for an alternative methodological approach. Some, such as Alexander Wendt (1987), suggest that any analysis that takes structure into account must examine how agent and structure are mutually constitutive. Consequently, Wendt calls IR theory to task for not providing a theory for the emergence of the state and the state system. Others suggest that, since agent and structure are at all times intertwined in dialectical interaction, one should not focus on either category. Instead, analysis should be premised on distinguishing historically configured processes and role patterns.

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HENDRIK SPRUYT

sub-Saharan Africa (SSA)

Despite prevailing stereotypes, sub-Saharan Africa (SSA) is not just civil conflicts and peacekeeping responses – the apparent 'coming anarchy' of Robert Kaplan (1994). Rather, its political economies/cultures present a rich tapestry of diversity: from tropical products and gold and diamond mines to internet servers and ecotourism. This continent has 'emerging markets' as well as regional struggles, satellite communications as well as drug smugglers, oil fields as well as natural disasters. And, while SSA remains marginal in the world economy compared to other (sub)continents, it contains the majority (three-quarters) of the world's highly indebted poor countries (HIPC's) and is crucial for the global ecology – biodiversity and oxygen – as well as for many NON-GOVERNMENTAL ORGANIZATIONS (NGOs) (Shaw and Nyang'oro, 2000).

Africa's political economies/cultures have changed dramatically since the early 1980s, when drought and debt began to make themselves felt: the impact of incremental international financial institutions (IFIs), advanced 'structural adjustment' reforms and conditionalities (see STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs)), and economic LIBERALIZATION in the decade of the 1980s, reinforced by post-COLD WAR political liberalization in the 1990s, on to formal multiparty politics and the CIVIL SOCIETY. State-economy

and state-society relations had been quite transformed by the end of the twentieth century by contrast to the heady days of post-colonial nationalism, with less state and more privatization, along with more roles and responsibilities for NGOs. The sustainability of the continent's sometimes forced attempts at democratization is problematic. Nevertheless, SSA does contain more investment centres and EXPORT-PROCESSING ZONES (EPZs) than ever. And it includes its own examples of transnational corridors and triangles, such as the corridors from Maputo and Walvis Bay to Gauteng and the triangles around Durban and Lagos.

While formal regional exchange remains stubbornly low, informal sectors are blossoming in both legal and illegal products, from food and consumer products to drugs and guns. SSA is attracting more FOREIGN DIRECT INVESTMENT (FDI), both extra- and intra-continental, especially in new mines and communications technologies. While the Johannesburg Stock Exchange dominates the continent, 'emerging markets' flourish from Mauritius to Ghana, through Botswana, Kenya, Namibia, Zimbabwe and so on. The well-established South African conglomerate, AngloAmerican Corporation, is now challenged in the mining sector by Ashanti Goldfields of Ghana; both are investing throughout SSA, as well as overseas in extra-African mineral-rich economies like that of Canada.

Although SSA has more internal conflicts with regional implications than any other continent, these do not mean there is no economic activity: the conflicts just increase prices, as well as the danger, of extraction and transportation, let alone accumulation. Despite valiant efforts at conflict prevention and confidence-building, SSA has endured a series of persistent civil wars, from the Southern Sudan and Ethiopia to Liberia, Sierra Leone and Angola. These hardly qualify as 'complex political emergencies' as their roots lie deep, including ethnic as well as economic dimensions. The claims of altruism for so-called 'humanitarian interventions' are beginning to wear thin perhaps another type of 'aid fatigue'

– despite the best efforts of the UN Secretary General to keep African peacebuilding on the global agenda (United Nations, 1998).

Notwithstanding hopes for an 'African renaissance' (Vale and Maseko, 1998), at the end of the twentieth century inter-regime alliances threatened to divide much of the Great Lakes region, from the Horn to Congo, with profound implications for the prospects of development. Inter-state alliances thus joined myriad peace-support operations, including NGO involvement that ranges from 'partnership' to 'subcontracting', to provide educational, health and other basic needs for sizeable refugee populations. Such peace-support operations were juxtaposed with warlords and private armies from Executive Outcomes and Sandline to The Lord's Liberation Army and other child-soldier formations.

Moreover, mass movements of people continue, sometimes away from conflicts (economic and ecological, as well as political) and sometimes towards economic opportunities (part of the process of urbanization, especially in post-apartheid South Africa's major cities: Johannesburg, Cape Town and Durban).

While orthodox analyses may decry the continent's apparent absence of growth, let alone development, more critical and nuanced perspectives recognize a range of innovative economic and political responses to economic and political liberalization, including informal market forces and alternatives to collapsed states. Substantial regional exchange occurs around SSA's myriad borders and is leading to novel regional political economies, whether or not these are recognized by the IFIs or the UNITED NATIONS ECONOMIC COMMISSION FOR AFRICA (ECA). Regional centres include the cores, as well as urban peripheries, of cities like Abidjan, Accra, Dakar, Addis Ababa, Harare, Johannesburg, Kinshasa, Lagos, Luanda, Nairobi and so on, and these contain not just the 'modern' infrastructure of airports, stock exchanges and telecommunications, but also the dynamic informal sectors of micro-credit, secondhand clothes, recycled plastics and repair workshops for cars to electronics (Shaw and van der Westhuizen, 1999).

subsidies

In short, there are many ways that SSA challenges assumptions and projections about global and local development: novel perspectives for political economy may yet come from Africa (Shaw and Nyang'oro, 2000).

See also:

highly indebted poor countries (HIPC) initiative; Lagos Plan of Action (LPA); United Nations Economic Commission for Africa (ECA)

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Also see the website www.un.org/ecosocdev/geninfo/afrec for more information.

TIMOTHY M. SHAW

subsidies

A 'subsidy' is defined as financial assistance granted by a government or philanthropic foundation to a person or association for the purpose of promoting an enterprise considered beneficial to the public welfare. Because the motivations and impacts associated with government subsidies differ considerably from those associated with private foundations, the following discussion will be confined to subsidies of a governmental nature.

Subsidies were used in England in the later Middle Ages, when parliament granted funds to the king to augment or replace customs and other taxes collected by royal prerogative; such early subsidies later became the means by which the power of taxation was taken from the king and lodged in parliament. At first a nationwide levy, it became (in the reign of Charles II) a land tax levied annually without the intervention of a parliamentary vote. In France, the king was able to retain his control and acquire financial powers that made him independent of any subsidy granted by the States-General.

The term 'subsidy' has had widely varied usage in the twentieth century. Subsidies may be granted to keep prices low, to maintain incomes or to preserve employment. They are most important as grants to private corporations for performing some public service, such as to shipping companies and airlines for carrying the post or to railways for maintaining passenger service. These are often required where a necessary public service, particularly

one which might otherwise not be profitable, is granted funds to remain in operation.

Today, medical and educational institutions are among the largest recipients of subsidies; in the 1990s, for instance, federal spending in the United States paid on average more than 40 per cent of national medical costs. Subsidies have also been granted by one country to another country to aid it in pursuing a war effort, to gain its goodwill or to help stabilize its economy.

Several issues surround government subsidies. First, subsidies are a major instrument of government expenditure policy. Second, on a domestic level, subsidies affect domestic resource allocation decisions, income distribution and expenditure productivity by reducing the flexibility of the economy. Third, on an international level, increased international INTEGRATION, through trade and the proliferation of multilateral and bilateral arrangements, brings about questions regarding the extent to which subsidies cause distortion in international resource allocation by affecting competitiveness.

Perhaps the greatest concern over subsidies centres on their tendency to create inefficiency in production, in the market and in the economy. Economic analysis suggests that the types and magnitude of inefficiency depend on the types of subsidies the government provides. In partial equilibrium models, a lump-sum subsidy does not affect a firm's production decisions and, therefore, results in no effect on efficiency. However, lump-sum subsidies under a rate-of-return regulation lead to allocative inefficiency and subsidy per unit of output creates deadweight loss in partial equilibrium models.

In general equilibrium models, subsidies create allocative inefficiency in the economy because they transfer resources from industries paying taxes to industries receiving subsidies. Furthermore, input-specific subsidies create allocative inefficiency in firms and RENT SEEKING by subsidized firms results in technical inefficiency. Inefficiency in a firm's operation can occur due to its management. Without competition and under government regulation,

a firm may create technical inefficiency (compare X-EFFICIENCY (XE)) due to its lack of effort to minimize cost. Such a firm may hold too much of one input over others or may pay excessively for an input. For example, with a strong pressure from unions, a firm may hold excessive labour or may pay a higher wage than the market offers. Mismanagement or wrong planning also may cause technical and allocative inefficiencies. An optimistic demand forecast may cause excessive capital investment and inflexibility of management may cause delay in input adjustments to changes in relative input prices from supply shocks.

On the surface, the notion of a subsidy seems straightforward. However, warnings from distinguished economists such as H.S. Houthakker that 'the concept of a subsidy is just too elusive to even define' suggest that a number of (often) arbitrary distinctions are used to define the concept. In the most general terms, a subsidy can be defined as any government assistance that (1) allows consumers to purchase goods and services at prices lower than those offered by a perfectly competitive private sector, or (2) raises producers' incomes beyond those that would be earned without this intervention.

Under this definition subsidies to consumers include cases where the government, as a producer of goods and services, sells its output at a price that does not reflect costs, including a normal return to capital, or compensates the private sector for doing so. Similarly, providing electricity at a price that does not reflect a normal rate of return on capital, even if there is no explicit budgetary cost, should be considered a subsidy. This definition extends beyond the narrower subsidy concepts that are employed in fiscal or national accounts and leaves room for a wide range of government activities to be defined as subsidies. However, such a broad definition is necessary to capture both explicit and implicit subsidy elements that are contained in different forms of government intervention.

While a wide array of government activity may contain subsidy elements, subsidies may be classified on the basis of these categories:

subsidies

- 1 Direct government payments to producers or consumers (cash subsidies or cash grants).
- 2 Government guarantees, soft loans (that is, low-interest government loans) or interest subsidies to enterprises (credit subsidies).
- 3 Reductions of specific tax liabilities (tax subsidies).
- 4 Government provision of goods and services at below-market prices (in-kind subsidies).
- 5 Government purchases of goods and services at above-market prices (procurement subsidies).
- 6 Implicit payments through government regulatory actions that alter market prices or access (access subsidies).
- 7 Government equity participation (equity subsidies).

While fairly comprehensive, this classification scheme still has several conceptual and operational limitations. For one thing, the various subsidies contained within each of the seven categories are not homogenous. Second, some subsidies may at least *a priori* belong to several different categories. Finally, there are still ambiguities and measurement problems. For example, overvalued exchange rates affect market prices and access, and while they contain a subsidy element (for example, to those who purchase imported goods), they also entail costs of negative subsidies (for example, to exporters); the full extent of the subsidy element of overvalued exchange rates may be difficult to establish.

It should be noted that the two standard sources on government subsidies, the UN System of National Accounts and the IMF Government Finance Statistics use a narrow definition of government subsidies which includes only unrequited, non-repayable government payments to compensate for losses on the current operations of enterprises. As a result, recorded subsidies most often reflect payments for losses resulting from the pricing policies of the government.

There are numerous reasons why governments may decide to use subsidies as a policy tool. Somewhat cynically, Houthakker (1972) has argued that a main reason has to do with

political vote-buying. From an economic perspective, the main purpose of subsidies is to reallocate resources – that is, to alter economic activity and behaviour to achieve an outcome that is more desirable than what would occur otherwise. Hence arguments for subsidies are often based on some concept of efficiency or economic justice. But even when subsidies generate a more desirable outcome, it does not mean that the entire value of the subsidy is corrective in nature or that the particular type of subsidy used for a given purpose is the best among the available policy alternatives.

Economic arguments for using government subsidies generally fall into four broad categories:

- 1 Offsetting various market imperfections.
- 2 Exploiting economies of scale in production.
- 3 Meeting social policy objectives (including, for example, protecting the poor).
- 4 Changing the distribution of income and increasing or retaining employment.

Often, however, those sectors receiving the largest subsidies do not clearly meet these criteria. Education subsidies in the United States are a prime example. In the early 1990s, the US government was spending nearly \$300 billion on education or around 15 per cent of all government spending, making it the third largest single type of government expenditure behind only national defence and social security. Meanwhile, government revenue collected from education was only around \$30 billion. This \$270 billion subsidy was roughly 5.5 per cent of net national product. Clearly, the choice to subsidize education is an important one and this choice seems to be widely accepted as a good decision. But the reasons why subsidizing education is a good choice are not so obvious.

Unlike a public good like national defence, markets can and do provide education. It is not clear why the government should subsidize this good, rather than let markets work unimpeded. Several normative justifications for subsidizing education have been put forth. There are four main types: equity, paternalistic, borrowing constraint and externality arguments (see ex-

TERNALITIES). None of these is completely compelling, becoming even less so as one progresses from primary to secondary and on to higher education. For example, few would argue against economic equality, especially equality of opportunity. This value judgement justifies helping the disadvantaged gain access to education; it does not, however, justify subsidizing the educational opportunities for all income classes.

Most economists find the second type of argument even less compelling. The various paternalistic arguments are based on the presumption that people do not fully recognize the benefits associated with education and thus do not purchase enough education on their own. Therefore, those who are fortunate enough to fully recognize the benefits of education argue that the subsidy is necessary to induce the less enlightened to make better choices. There are two major problems with this argument, however. It is difficult to objectively justify why many people do not fully appreciate the benefits of education while there are some enlightened ones who do. There is a similar problem in objectively distinguishing the enlightened opinions from the unenlightened.

The third justification argues that many students are constrained from borrowing against their potential future income to finance their education. This capital market imperfection (largely due to government-imposed constraints) may cause many students to acquire less than efficient amounts of education. This obstacle to opportunity may be viewed as inequitable as well. But if this borrowing constraint is the problem, then government-supported loans are the obvious solution. There is no reason to lower the private cost of education and redistribute income to all publicly educated students, as subsidies do.

The fourth justification has received the most attention by economists. If acquiring education produces spill-over benefits, self-interested individuals will acquire less than socially efficient amounts of education. A subsidy internalizes the externality and encourages students to acquire more efficient

amounts of education. A common view, however, is that although these external benefits probably do exist, it is unlikely their magnitude is large enough to warrant a subsidy as large as the one observed, particularly at the level of higher education. It seems improbable that the marginal external benefit is as substantial as the subsidy. If the above arguments are valid, one is apparently left with the disturbing conclusion that subsidizing education, particularly higher education, is mostly a redistribution that is inequitable by commonly accepted standards of equity.

While one has a hard time making the case for subsidies to education in the developed countries, their rationale is easier in the developing world, where market imperfections and poverty are much more prevalent. Here the general rule of thumb is that policies should be promoted by which the beneficiary of education (as opposed to the student's family or society as a whole) would bear a larger proportion of educational costs as they proceed as a student through the system. At the same time, low-income groups should be provided with sufficient subsidies to permit them to overcome the sizeable private costs (including opportunity costs) of schooling.

With regard to market imperfections, economic theory (as developed by ALFRED MARSHALL and particularly A.C. Pigou at Cambridge in the early 1900s) often examines subsidies in conjunction with taxes as a means of bringing marginal private costs or benefits more closely into alignment with marginal social ones. The need for alignment arises when externalities (whether economies or diseconomies) operating at the margin, cause a divergence.

Externalities may be between firms, where they are caused by technological interdependence between production functions – one firm's production function containing an input or an output proper to another firm's. They may be between consumers, with one consumer's utility function containing a variable proper to another consumer. Or they may be between consumers and firms. Optimizing behaviour by consumers and firms implies that

subsidies

marginal private costs and benefits will be equalized. If these coincide with social costs and benefits, they too will be equalized; if not, there will be a measure of MARKET FAILURE. Market failure means that all mutually beneficial bargains have not been struck and that it is possible to make one or more participants better off without making anyone worse off. Efficient (or Pareto efficient) markets imply the exhaustion of all such opportunities.

In contrast to education, the case for using government subsidies to offset various market imperfections is fairly straightforward, as it is geared towards increasing efficiency. As noted above, the argument applies to a case where markets do not allocate resources to their most efficient use, usually because the owners of these resources cannot reap their full return. In theory, a second-best policy tool such as subsidies may offset market imperfections by changing existing incentives. For example, FREE RIDER PROBLEMS usually lead firms to underinvest in RESEARCH AND DEVELOPMENT (R&D) activities. Firms undertake R&D in the hope of selling products based on the discoveries made; potential competitors, however, may use the knowledge thus obtained and take a share of the profits without incurring the costs.

Clearly, it may be rational for an individual firm (or country) to underinvest in R&D and instead capitalize on the R&D of others. Subsidizing firms to undertake R&D activities would be one way to overcome this problem. Similarly, informational asymmetries can be viewed as an example of a market imperfection. Informational asymmetries, for example between borrowers and lenders of funds, can lead to market interest rates above the social rate of return. This would imply that socially profitable undertakings will not be implemented. A possible remedy is credit subsidies, provided (for example) through subsidized interest rates.

Similar arguments can be used to subsidize enterprises in order to obtain ECONOMIES OF SCALE of production. For example, when foreign-owned firms have a cost advantage because of their larger size, a government subsidy could allow a domestic firm to expand and overcome its initial competitive disadvan-

tage in international markets and therefore compete successfully in the long run. In theory, this could shift enough profits to the domestic firm (that in turn can be taxed) to justify the cost of the subsidy and enhance overall welfare. The subsidized entry into the widebody aircraft market by the European AIRBUS CONSORTIUM is an example of this strategy. The industry is characterized by significant economies of scale and had been dominated by two US producers: Boeing and McDonnell-Douglas. The Airbus Consortium was created when small European firms feared they would disappear if they were to continue competing against each other. The presence of Airbus transferred to Europe some of the profits and other benefits that otherwise would have gone to US producers, although it is still unclear whether the size of the profit transfer alone was large enough to justify the subsidies received.

In both cases, market imperfections and economies of scale, successful subsidization requires that the government is able to make the right decision (that is, pick winners), at least as long as there is a binding budget constraint and the government has to choose between different possible alternatives. 'Picking winners' usually requires good analytical capacities, an in-depth knowledge of different industries and activities, and accurate foresight. In the case of subsidies for R&D, for example, this would require knowing the likely future rates of return to different research projects. In the case of increasing a country's international competitiveness by exploiting economies of scale, the government would need to evaluate the long-run costs and benefits of subsidizing different industries and assess the long-term prospects of competing activities. Also, it must take into account that other countries may retaliate; this could exacerbate international trade tensions and lead to a counterproductive spiral of offsetting subsidies between trading partners.

Finally, as with education, social-policy objectives (such as a more equal distribution of consumption or income) provide important reasons for subsidies. Often, however, these goals are not accomplished, or at least they are

not accomplished at minimum cost. For example, many economies maintain generalized food subsidies in the form of fixed prices for essential staple goods as a key social safety-net. Generalized food subsidies have the advantage of not generating exclusion errors, since nobody is excluded from receiving the benefit, at least in principle. At the same time, they generate inclusion errors and therefore may entail substantial waste, as many unintended beneficiaries (those who do not need the subsidy, or more generally, the non-poor) also benefit from the policy. In addition, they may easily generate adverse supply effects. Clearly, in many cases governments have insufficient information to target efficiently. Providing subsidies in kind (for example, in the form of subsidized goods) instead of cash may target more efficiently people with high needs.

In general, for subsidization policies to be successful, it is necessary to avoid generating rent-seeking behaviour. Frequently subsidies may benefit well-placed groups and distort incentives, which puts the desired distribution and resource-allocation effects into doubt.

The overall micro- and macro-economic effects of subsidies are closely linked to how they are provided. In the short-run, however, subsidies may neither have a direct budgetary cost, nor generate an immediate burden on taxpayers or households. Therefore, the short-term financial cost of a subsidy may not be a good indicator of the real welfare cost and the allocative and distributional implications. Ultimately, however, subsidies must be paid for. Therefore, it is important that subsidies are effective (that is, reach their intended target group) and achieve a given objective at minimum cost (in terms of budgetary outlays and any economic distortions the subsidies may cause).

In practice, subsidies are often ineffective (that is, they fail to benefit their intended target group) and costly (they have adverse real welfare and distributional implications). This is regardless of whether they directly affect public expenditure (for example, cash subsidies or implicit subsidies that are hidden in other expenditure categories or provided through

quasi-fiscal operations) or not (as in the case of tax or regulatory subsidies). Needless to say, the welfare costs of subsidies usually go beyond their explicit or immediately visible budgetary or quasi-fiscal cost. In effect, subsidies lead to overproduction of the subsidized good, since production and consumption are expanded beyond the point where the marginal social benefit of consuming the good is equal or greater than the marginal social cost of production. The efficiency losses associated with subsidy programmes can be substantial.

Subsidies may often have unintended effects on resource allocation. For instance, when introducing a subsidy for imported foodstuffs that lowers the consumer price for these goods, the quantity demanded may increase as well, so that it may become necessary to increase imports in order to avoid shortages. This, in turn, will affect the availability of foreign exchange, leading to pressures to reduce other imports or depreciate the exchange rate.

Adverse distributional effects can be expected to be particularly strong when market imperfections provide opportunities for rent seeking. For instance, price controls on agricultural products that lower the price below the competitive market equilibrium will, in all likelihood, result in shortages if imports are not allowed to fill this gap. The shortage will provide opportunities to earn economic rents for well-placed groups that have privileged access to the product at the controlled price. The poor (presumably the group that the price control seeks to protect) may frequently not have access to the subsidized product at its controlled price. The net result may be that, on average, consumers end up paying a price that is higher than the competitive market price, with the benefit of the price-control policy accruing to traders.

While generalizations are difficult, the literature points to several main findings concerning subsidies:

- 1 Even if there appears to be an economic case for a subsidy, the information needed to calculate the exact rate to offset the market imperfection is rarely available. Too big a

subsistence wages

subsidy could worsen the distortion.

- 2 Governments are generally less adept at picking winners than the private sector. All too often, decisions are clouded by social factors such as job creation.
- 3 Government support of R&D may simply displace private-sector R&D with no overall increase in activity.
- 4 If one government subsidizes an export industry, others are bound to retaliate, triggering a subsidy war.
- 5 Even if a subsidy can be shown to yield a net social benefit, this usually overlooks the economic cost (for example, work incentives) of raising extra taxes to pay for the subsidy.

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ROBERT LOONEY

subsistence wages

In nineteenth-century England, there were many workers who were simultaneously wage labourers and paupers. The wages received by many agricultural and urban workers were so low that these workers could only afford even the most basic of necessities if they also received charity from their parishes. It was necessary to use the Poor Law (enacted to protect the elderly,

sick and orphans) to provide protection for many wage earners, especially during times of economic crisis. In countries where CAPITALISM developed first, the population had to work extremely long hours. In England at the end of the eighteenth century, for example, the working week was six twelve-hour days. Children in workers' families were also obliged to work exhaustingly long hours: the country's labour law of 1833 was enacted to restrict the working day for people between thirteen and eighteen years of age to twelve hours, and for children between nine and thirteen years old to no more than eight hours.

Low wages and long hours of work – the reality of eighteenth- and nineteenth-century capitalism – gave credibility to the theory maintained by THOMAS MALTHUS and DAVID RICARDO, among others, regarding a 'natural rate for wages' – established at the level of physiological subsistence and designed to keep the workers' population reproducing itself at a constant rate. If wages were to be fixed below this natural rate, hunger and sickness would create an imbalance in the labour supply that would lead to an increase in wages until they reached their natural level. If wages were taken above the natural rate, population growth would be stimulated, creating a surplus of workers and thus leading to a drop in wages. Using this theory, Malthus and Ricardo fought against the Poor Law'. Ricardo argued that while legislation for the poor was originally enacted to improve their economic situation, it had only managed to impoverish the rich and, for this reason, all those who were genuinely interested in helping the poor should work to repeal any legislation that obstructed the adjustment of wages to market demands.

In today's industrialized countries, the hopes of the classical economists have been surpassed by reality: the vast majority of the population has reached a satisfactory standard of living. Even in industrialized countries, however, it has been necessary to fix wages at a level that guarantees the subsistence of wage earners. In New Zealand, a minimum wage was established by law in 1894; this standard was later accepted in most other countries. In the United

States, for example, the Fair Labor Standards Act established minimum wages for certain workers in 1938. In general, setting a minimum wage seeks to guarantee the necessities – food, housing and education for workers' children – on the basis that there is only one earner per family. In many countries, however, minimum wages do not fulfil their objective, as they are set below the subsistence level and oblige women to not only carry out domestic tasks but also take on paid work. It remains a necessity for many families that their children work. The lack of a satisfactory level of wages continues to be a problem, with a considerable part of humanity still facing the hardships of POVERTY.

See also:

population growth

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B. GLORIA MARTÍNEZ GONZÁLEZ

substitution effect

A price rise or a price fall changes the relative prices of goods. Consumers tend to reduce their consumption of goods that become more expensive relative to other goods, all other things being equal. Similarly, they tend to increase their consumption of goods that become relatively cheaper. When the price of any good rises, consumers thus tend to substitute other goods. This adjustment of quantities demanded to the change in relative prices is called the 'substitution effect'. It always increases the quantity demanded of a good whose price has decreased and always

reduces the quantity demanded of a good whose price has risen.

M. PETER VAN DER HOEK

Super 301

Super 301 – more properly Section 301 of the United States Trade Act (see OMNIBUS TRADE ACT) – enables the president of the day to take action against countries that are deemed to have undertaken unjustified or unfair international trade practices. Such practices include those detrimental to the United States or its industry, denial of market opportunities or persistent denial of the rights of workers, or other inequitable practices. A period of bilateral negotiation is initiated, before proceedings are taken to the WORLD TRADE ORGANIZATION (WTO). During negotiations, accused countries have the opportunity to demonstrate their activities are not contrary to multilateral agreements, to rectify supposed shortcomings or to provide suitable compensation. US authorities issue summons as if to suspected criminals and then try to judge cases according to US law. That is, Super 301 provides powers that are completely separate from and above those provided by multilateral agreements such as the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) or the WTO. This has led to a number of countries accused under Super 301 reacting with irritation and even outrage at such unilateral behaviour, particularly as there is reason to suppose that *realpolitik* often dictates the choice of country to be accused.

See also:

General Agreement on Trade in Services (GATS); tariffs

JOHN WALSH

super-accumulation

'Super-accumulation' is a concept which is derived from Marx's analysis of capital accumulation – the process whereby SURPLUS VALUE reaped from investment is ploughed back into more investment in capital stock which, in turn, is driven by competition among capitalists to achieve lower cost–output ratios and greater market share. Progressively increased accumulations of capital are the reiterated outcome of this process. By the last decades of the twentieth century, 'super-accumulations' of capital had come to dominate or control the industrial, banking, agricultural, retail and mass-communications sectors of the global economy. Ever larger mergers of corporations, declining input costs of labour and resources with government DEREGULATION and technological advances, and steeply declining capital gains and corporate taxes, further compounded these super-accumulations of capital in a world market increasingly free of regulatory inhibitions, TARIFFS and social performance requirements.

Absolute capital accumulation occurs when all of the profits of investment are returned to the next investment sequence, becoming cumulatively more money inputs and higher money outputs with each non-recessionary business cycle. By 1998, the world's 225 greatest personal accumulations of capital exceeded in monetary worth the income of 47 per cent of the world's people, while the accumulated capital of the largest transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) yielded more gross annual income per corporation than most of the world's nations. Accumulations of capital are called 'super-accumulations' as they became more extreme in their absolute and relative capital holdings; these continue to become greater capital accumulations the more that successive profit returns are not spent, taxed or redistributed, but are instead recruited back into further capital growth.

As super-accumulations of capital seek to become maximally greater accumulations at rising velocities and volumes, an external

consequence follows for surrounding people and environments whose resources are increasingly appropriated as material inputs and throughputs to feed the growth requirements of this accumulating capital. This process of life-system appropriation has been analysed as carcinogenic in the uninhibited self-multiplication and systemic decoupling of capital circuits from any committed function to life-hosts (McMurtry, 1999). As deregulated super-accumulations of increasingly liquid capital move opportunistically across borders to higher-yield profit sites under a global regime of 'free capital flows', societies across the world suffer 'meltdowns' from the sudden entries and exits of vast sums of 'hot money' seeking to maximize further capital holdings.

Late twentieth-century conditions that have contributed to capital super-accumulation have been the rapid post-1980 growth of compounding interest receipts, the removal of investment and trade barriers precipitating a 'race to the bottom' for lower input costs, radical advances of electronic computer technology replacing labour forces and communicating speculative profit margins across continents in nanoseconds, and leveraging of money stocks without gold standard or reserve requirements to historically unprecedented ratios. Combined with public authorities' unwillingness or inability to regulate, tax or redistribute these increasingly monolithic super-accumulations of capital, the classical logic of capital accumulation which Marx analysed – reinvestment of acquired capital for more advanced forces of production – has been replaced by a super-accumulation of capital increasingly decoupled from domestic societies, environmental requirements and material production itself.

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JOHN McMURTRY

superpowers

The term 'superpowers' refers to the United States and the Soviet Union during the COLD WAR period following World War II. The Cold War superpowers were hegemons with substantial authority over large parts of the globe, as well as the military, political and economic means to maintain that authority. Noteworthy among these means were their vast arsenals of nuclear weapons and thereby their ability (given the will) to annihilate their opponents.

At the end of the twentieth century, the world arguably has one superpower: the United States. The United States maintains the ability to secure vast territories and control resources, and it has the capability to maintain influence over the foreign policies of other states. To be sure, the United States does not exercise this authority as often as it might and the cooperation it engenders from other countries is largely voluntary. However, the US economy and American military capabilities remain 'super' and, given the will, the United States may be able to maintain its superpower status even in the face of opposition.

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PAUL G. HARRIS

superstructure

'Superstructure' is an all-encompassing term originally used by KARL MARX and Friedrich Engels to refer to the political-legal arrangements and forms of social consciousness that, in all but the most primitive societies, are determined by the economic structure (or base). A rather broad and at times indeterminate concept, superstructure embraces not only the institutions and practices of the STATE,

LAW, culture and intellectual life, but also their systematic expression in IDEOLOGY. Despite its exhaustive coverage, however, superstructure has no specific autonomy, but rather is founded in and shaped by the social RELATIONS OF PRODUCTION. It is those relations that determine, for example, the specificity of the state form and the prevailing ideas that come into being in any historical period.

Despite its extraordinary influence within Marxist political economy and social theory (see MARXISM-LENINISM), the posited relation between superstructure and economic base has always been the subject of immense controversy. The charge most often levelled is that of economic reductionism: that all aspects of social life are thereby reduced to (and explained in terms of) the social relations of production, rather than allowing for specific determinations emanating from within the superstructure itself. However, such arguments tend to ignore Marx and Engels' own assertions that, in its specific historical – as opposed to general – form, the relationship between the superstructure and social relations of production may be an uneven one and may result in the former asserting a 'reciprocal influence' over the latter.

Since Marx, however, there has been a greater recognition among Marxists of the need to account more thoroughly for independent determinations by the superstructure. Most influential among these have been the work of French structuralist Louis Althusser and Italian communist ANTONIO GRAMSCI. For Althusser, while the economic base will always assert an ultimate determination over the superstructure (even if only 'in the last instance'), aspects of the superstructure may nevertheless act as 'structures of dominance' in any historically specific social totality; in Gramsci's work, the concept of HEGEMONY is employed to suggest that politics and ideology are not simply given reflections of economic relations, but rather are constituted in struggles that extend beyond the immediate interests of any dominant or ruling class.

See also:

economism; Marxian economics

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ROHIT LEKHI

supply-side economics

'Supply-side economics' is school of economic thought emphasizing that the main source of a country's economic growth is constant improvement in the efficiency with which resources are allocated for production. While the policy recommendations of the rival Keynesian School (see KEYNESIAN ECONOMICS) tend to focus almost entirely on what government can do to stimulate or restrain aggregate demand in the short-run so as to even out the business cycle, supply-side policy analysts – while not necessarily going as far as SAY'S LAW (supply creates its own demand) – focus primarily on ways of expanding production. In this regard, supply-side economics stresses the importance of identifying ways in which the government can promote faster economic growth over the long haul by removing impediments to the supply, and efficient use, of the factors of production. Supply-siders believe that unwise provisions of the tax laws (and especially high marginal rates of personal and corporate income taxation) produce very damaging incentives that lead people to work less and to invest less (and to do both less efficiently) than they otherwise would.

Supply-side policies gained great favour with the Reagan administration in the United States during the 1980s and are often referred to as

the basis of 'REAGANOMICS'. As implemented by that government, supply-side economics provided the general guidance for income-tax cuts, new expenditure priorities, monetary restraint and regulatory reform.

In one sense, supply-side economics is merely the application of price theory or micro-economics to the analysis of problems concerning economic aggregates or macro-economics. Its conceptual antecedents are to be found in the work of the classical economists of the modern era, from ADAM SMITH and J.B. Say through MILTON FRIEDMAN. As such, it represents no new body of theory; rather it entails addressing the neo-classical mode of analysis (see NEO-CLASSICAL ECONOMICS) to public economic policies, whether these are focused on concerns of the economy as a whole or on specific areas of economic activity.

In another sense, supply-side economics identifies several critical linkages associated with governmental actions. The initial effect of government actions is looked at in terms of the changes in relative prices (explicit or implicit) confronting households and businesses. It is the response by these private-sector entities to these relative price changes that determines the ultimate effects of the government actions. These responses involve changes in the allocation of existing production resources and claims on output which may result, more or less promptly, in changes in the total volume and/or composition of economic activity. In so far as volume changes occur, aggregate real income is also changed and this change in total real income will lead to further changes in economic activity. Since real aggregate demand is necessarily always equal to aggregate real income, these further changes in economic activity are depicted by changes in the components of aggregate demand. This sequence of effects, the precedence of price over income effects, is one of the critically important premises of the supply-side analysis.

Supply-siders often refer to the effect of government activities on relative prices as the 'first-order' effect and the consequences of private-sector responses as the 'second-order' effect.

Equivalently, the supply-side analysis points out that government actions first affect the allocation of resources and that one of the consequences of any such allocative effect may be a change on the level of economic activity. This mode of analysis similarly holds that these allocative effects of fiscal actions also largely determine the distributional consequences of fiscal action. However, the basic supply-side proposition denies the possibility that government action can initially and directly change the total real income of the economy. Instead, supply-side economics emphasizes that fiscal policy works by changing relative prices or incentives. High income-tax rates and regulation are seen as disincentives to work and production, regardless of the level of demand. Lower tax rates encourage saving, investing, working and risk-taking. As people switch into these activities out of leisure, consumption, tax shelters and working for non-taxable income, the incentive effects cause an increase in the market supply of goods and services – thus the name ‘supply-side economics’. As people respond to the higher after-tax income and wealth, or greater profitability, incomes rise and the tax base grows, thus feeding back some of the lost revenues to the treasury. The saving rate also rises, providing more funds for government and private borrowing.

Specifically, supply-side economics focuses on two important relative prices. One governs people’s decisions about how they allocate their income between consumption and saving. The cost to the individual of allocating a dollar of income to current consumption is the future income-stream given up by not saving and investing that dollar. The present value of that income-stream is influenced by marginal tax rates. The higher the marginal rate, the lower is the value of the stream. High tax rates make consumption cheap in terms of foregone income and the saving rate declines, resulting in less investment.

The other important relative price governs people’s decisions about how they allocate their time between work and leisure or between leisure and improving their education and skills. The cost to a person of allocating

additional time to leisure is the current earnings given up by not working or the future income given up by not taking courses to improve skills. The value of the foregone income is determined by the rate at which additional income is taxed. The higher the marginal tax rates, the cheaper the price of leisure. Absenteeism goes up, willingness to accept overtime declines and people spend less time improving their work skills.

Supply-siders argue that taxes like the progressive income tax work as a barrier to upward mobility and discourage people from making their best efforts. As a result, the tax system can make it more difficult for the average taxpayer to achieve financial independence. It is this barrier to success that supply-side economists attacked. The greater the extent of private success, the smaller the need for public assistance and the lighter the burden of government. Supply-side economics is not anti-government. It simply accepts the fact that the government is costly by nature and maintains that the greater the incentives and opportunities to earn income, the smaller will be the size and burden of government.

The application of supply-side analysis entails major changes in budgetary, fiscal and monetary policies. A fundamental implication of the supply-side analysis is that there is no pay-off in focusing fiscal policy on the control of aggregate demand. A corollary conclusion is that there is no valid purpose to be served by attempting to set government spending targets by reference to the supposed contribution of these outlays to aggregate demand. Similarly a policy focus on the total amount of tax revenues is inappropriate as a means of influencing the level or change in total economic activity. In the same connection, the size of the deficit should not be perceived as a relevant variable for policy manipulation in the interests of attaining designated levels or rates of growth in employment, output and income.

One of the major implications of these conclusions is that public economic policy should substantially forego short-run economic stabilization as a policy objective and focus instead on more attainable and more relevant

concerns. These include reducing (if not eliminating) government-induced misallocation of the economy's production capacity resulting from the distortions of relative prices produced by taxation, spending and regulatory policies. In consequence, the policy focus should shift to facilitating more efficient function of the private market system and to allowing the economy to achieve its potential growth over the long run.

Rejection of the aggregate demand approach in favour of the supply-side analysis leads necessarily to a change in the appraisal of the effects of fiscal actions on the price level. In the aggregate-demand analysis, tax and expenditure changes generate changes in aggregate demand which, since conditions of supply are deemed to be unchanged by fiscal actions, lead to increases or decreases in inflationary pressures. In contrast, the supply-side analysis delineates fiscal actions as impacting on aggregate demand in real terms only in so far as they first affect aggregate output by way of price effects. Thus an income-tax rate reduction, by virtue of its relative price effects, generates increases in output and in the supply of labour and capital services.

Rigorous application of the supply-side analysis leads to rejection of the view that budget deficits *per se* are inflationary or that increases in government outlays are the root cause of inflation. This view of budget deficits as a source of inflation rests on the observation that those deficits tend to be monetized. This is not an inherent or necessary consequence of budget deficits. Much depends on how the deficit originates. In so far as it results from tax or spending actions that depress or inadequately stimulate private-sector saving and is financed by a greater monetary expansion than would otherwise occur, this in turn may result in accentuation of inflationary pressures (depending on what the thrust would have been without the deficit). On the other hand, some fiscal actions (in particular supply-side tax reductions that reduce the relative cost of saving) are likely to generate a sufficient increase in private-sector saving to obviate the

need for any monetary expansion to finance the deficit that such tax cuts produce.

A major policy prescription which flows from this analysis is that the traditional institutional link between monetary expansion and government deficits should be broken. Monetary policy should take the form of slow and steady growth in the stock of money, substantially oblivious to budget prospects or outcomes.

One of the principal analytical outputs of supply-side economics is the rejection of the so-called 'Phillips curve relationship' between inflation and unemployment. By the same token, it rejects the view that price-level stability can be purchased only at the cost of unacceptably high levels of unemployment or that acceptable growth in employment depends on pursuit of fiscal and monetary policies likely to spur inflation.

As noted, supply-side economics became particularly well known to the general public during the 1980s because of its advocacy by one influential faction of economic policy-makers in the Reagan administration, leading to the use of the term 'Reaganomics' to denote many of the ideas of the supply-siders. As implemented by the Reagan administration, supply-side policies were not designed to secure more revenues for the government or to balance the budget. Instead, these policies were directed towards overcoming the economy's inability to grow without increasing inflation and towards reversing the decline in the competitive position of the United States.

During the 1970s, productivity growth declined sharply. Policy-makers were confronted with worsening Phillips curve trade-offs between inflation and unemployment, ending in both rising inflation and unemployment – STAGFLATION. Also, in 1971, the US merchandise trade deficit turned negative; it grew dramatically during the latter part of the decade, despite the continuous fall in the dollar exchange rate.

Keynesian economists had great difficulty in explaining these developments and this failure created an opportunity for supply-side economists, who argued that the policy of pumping

up demand, while neglecting incentives to produce, had resulted in stagflation. As incentives eroded, each additional increment of demand called for less real output and more inflation. Supply-siders argued that improved incentives and lower costs imposed by government would result in a greater supply and more efficient use of productive units.

Keynesians have objected to the supply-side emphasis on relative price effects in fiscal policy. They have argued that decisions to work or save were either not affected by tax rates or were affected positively – that is, people would continue working or saving to compensate for the money lost to high taxes. They have also questioned whether incentives would be effective in time to deal with an immediate economic stabilization programme – that is, a recession or inflation.

Ultimately, then, the validity of supply-side versus Keynesianism is a matter of empirical fact. Here, both sides can muster up studies or economic developments supporting their positions. Supply-siders usually cite studies that show the responsiveness of saving, working and taxpaying to changes in tax rates. On the other hand, Keynesians usually point to the rapid growth in the fiscal and current account deficits during the Reagan administration as evidence of the absence of supply-side forces in the economy.

See also:

trickle-down

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ROBERT LOONEY

surplus capacity

While undergraduates' micro-economic textbook treatments of 'surplus' or 'excess capacity' are often fairly straightforward (surplus capacity results when firms are producing on the downward portion, rather than at the bottom, of a U-shaped average cost curve), the concept is fraught with a number of conceptual and measurement problems. Ultimately, any definition of surplus capacity will be somewhat arbitrary.

First, surplus capacity must be defined in terms of some sort of measure of ideal or optimal capacity for a firm or plant. Specifically, is the aggregate capacity 'just right' in the sense of being present in such an amount as to supply the demand in the most efficient way? Or is there redundant capacity that raises costs above the minimum attainable level?

A second issue concerns the treatment of obsolete capacity in the measure of surplus capacity. In the usual industrial setting, plant capacity will be of various ages, states of repair and degrees of technical competence. A plant is properly considered obsolete, however, only when because of age, old-fashioned technology or other factors, the cost per unit of output for simply maintaining and operating the existing plant exceeds the alternative cost per unit of output for building as well as operating and maintaining a new plant. Even according to this strict definition, obsolete plant capacity does persist in some industries, though often on a 'stand-by' non-operating basis or with a very low rate of utilization. Again, how much of this type of capacity should be considered 'surplus capacity' is arbitrary.

The causes and consequences of surplus capacity are also varied. Large excess capacity may mean that an industry is holding prices too high. However, it can be caused by a number of other factors as well: the general level of economic activity may be low; sales may have fallen off because the industry's products are going out of style; excess capacity may be due to past investment errors in the industry or to anticipated increases in demand.

surplus value

Since investment decisions constitute an element of competitiveness, current excess capacity may be due to the influence of past competitive forces. Indeed, CARTELS have purposely kept plant-size in check in order to avoid the pressures of excess capacity on price.

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ROBERT LOONEY

surplus value

Classical political economists from the physiocrats ADAM SMITH and DAVID RICARDO through to the pre-Marxian socialists had, in one form or another, a notion of a surplus product. It is with KARL MARX, however, that the concept of surplus value is properly associated.

Marx defined 'surplus value' as the additional value produced by labour in the process of production. Marx explains this production of surplus value within the circuit of capital denoted as $M - C (LP, MP) \dots P \dots - C_1 - M_1$ where M_1 and C_1 are greater than M and C respectively. A capitalist invests money (M) by buying labour power (LP) – the capacity to labour – and means of production (MP) – raw material, machinery and so on – which are commodity inputs (C). Through productive capital (P) these commodity inputs produce commodities (C_1). C_1 is greater than C because it contains surplus value in the commodity

form. The capitalist, however, has to realize this surplus in the form of money through market exchange, through which the capitalist receives M_1 which is greater than the original money (M) that was invested. In the realm of exchange, the total social surplus value across the economy takes the form of profit, rent and interest.

It is the origin of this surplus value that, as Marx himself said, has formed the most important problem of political economy from the physiocrats onwards. Marx argued that labour power – the capacity to work – was the source of surplus value. In contrast to those political economists who suggested that the surplus arose from inequalities in exchange (such as Ricardo), Marx showed how a seemingly fair exchange could result in the creation and extraction of surplus value. This allowed him to locate the creation of the surplus in production rather than circulation, and led him to develop his notion of the rate of surplus value or rate of EXPLOITATION.

The rate of surplus value refers to the ratio between the surplus labour (S) expended by a worker that is in excess of the necessary labour or variable capital (V) required to satisfy basic subsistence requirements. For example, suppose the worker has to perform five hours of necessary labour (V) in order to reproduce self and family. A capitalist sets the working day at ten hours, which means that the worker labours five hours for self and family and five hours for the capitalist. The worker has performed five hours surplus labour (S) and the capitalist has accrued a surplus value equal to five hours of labour time. The rate of surplus value or exploitation is, in this instance, $(5/5 \times 100) = 100$ per cent.

Marx denoted two ways in which this surplus value is extracted. Absolute surplus value refers to the way capitalists attempt to lengthen the working day and thereby increase surplus value. Relative surplus value involves reducing necessary labour, while still making the worker labour the full working day. This can be accomplished through productivity increases by making people work harder or by expelling labour and introducing machinery

into the production process. Marx used this increase in dead labour over living labour for his theory of the tendency for a FALLING RATE OF PROFIT (FRP). The working day, therefore, is an arena of CLASS STRUGGLE between capitalist and worker over the pumping out of surplus value.

The concept of surplus value was rejected out of hand by neo-classical economists who located the origin of the surplus in abstinence and the marginal productivity of capital (see NEO-CLASSICAL ECONOMICS). Even within Marxist discourse, however, surplus value and the LABOUR THEORY OF VALUE upon which it was based, came under sustained attack. Problems were particularly identified with the quantitative relationship between surplus value measured in value terms and profits which are measured in terms of prices. Writers such as PIERO SRAFFA indicated how prices and profits could be determined without any reference to values and surplus values. Moreover, post-Sraffians displayed the possibility of positive profits existing with negative surplus values. The quantitative problems associated with surplus value did not, however, detract from Marx's qualitative point that the existence of surplus value and its extraction indicated that capitalism was an exploitative system. Against fetishistic accounts of surplus production which missed the social basis to its creation, Marx displayed how capitalism was like any other system of domination. Surplus value is still seen, therefore, as a viable concept within orthodox Marxist political economy that emphasizes the social and antagonistic basis to economic production in capitalism.

Further reading

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IAN FRASER

sustainable development

The concept of 'sustainable development' has become popular as concerns have grown that contemporary economic patterns of production and consumption might be damaging the natural environment irreversibly and/or threatening to exhaust valuable natural resources. In general, the notion of sustainable development involves notions of patterns of economic and industrial DEVELOPMENT that do not entail substantial ecological damage and/or consume only those natural resources that can be renewed or replaced without great difficulty.

The problem with such a notion of sustainable development is the difficulty of differentiating it from a marked form of conservatism, in which any development that has any impact whatsoever on the natural environment is opposed automatically. Worse still, some views of sustainable development can be deployed in support of programmes for a 'return to nature' and/or forms of extremist environmentalist policy and protest.

If simple conservatism or environmental utopianism are rejected, however, the notion of sustainable development has to rest on more debatable notions of what is and what is not sustainable, given prospective changes in technology, economic patterns and consumer tastes. There is a degree of unknowability inherent in judgements about which economic patterns can and cannot be sustained in the future, given that technological development might generate substitutes for resources that are currently under pressure and alternatives to production and consumption patterns that are currently polluting. Moreover, as the current debate about the likely effects of GLOBAL WARMING illustrates, what might be unsustainable for some groups of people may be quite sustainable for others.

Sustainable development might thus serve well as shorthand for a range of responses to current environmental problems and pressures but, once detailed prognoses and prescriptions are involved, is likely to fall foul of the inherent unpredictability of future developments and

swaps

the diversity of interests and experiences of different sections of the world's population.

R.J. BARRY JONES

swaps

'Swaps' are a form of transaction where counterparties agree to exchange two sets of cash flows over a given time-period. Swaps are a form of DERIVATIVE and are thus used to manage risk or to speculate. The basic types of swaps are currency and interest-rate swaps. Interest-rate swaps exchange interest-rate payments based on an underlying amount of principal. Given that the principal never actually changes hands, it is known as the 'notional' amount. Currency swaps exchange debt or assets denominated in one currency for those denominated in another currency.

See also:

financial instruments; speculation

ADAM HARMES

SYNDICATED LENDING *see* debt crisis

systemic risk

RISK, in general, refers to the possibility of suffering losses, while risk assessment includes the assignment of probabilities to various alternative consequences. The sources of risk in the international economy are diverse. International businesses, including participants in global financial markets, encounter a variety of risks to their assets, such as (with some definitional overlap) currency risk, country risk, political risk, credit risk, market risk and liquidity risk. For businesses, the term 'systematic risk' refers to the minimum level of risk that can be obtained for a portfolio by means of DIVERSIFICATION. Systematic risks are those

inherent in the business environment, rather than in the specific nature of the industry, geographic region or the firm's operations. Systematic risk is difficult to avoid through strategies such as diversification because, by definition, it affects the entire industry or market simultaneously. Regulators are more commonly concerned with what they call 'systemic risk', referring to crises or disturbances that endanger the functioning or existence of an entire system, such as those involving global FINANCIAL INSTITUTIONS. Problems in one part or multiple parts of a system may become magnified by transmission across territorial borders and different types of markets. In the worst case, system breakdowns may result.

Systemic risk can be minimized or at least taken into account by market participants and regulatory authorities, although not perhaps as successfully as with other forms of risk. One risk-management strategy that regulators may use to counter systemic risk is to ensure the provision of accurate and timely information. Regulatory authorities can encourage the dissemination of relevant information on individual market participants and market trends through disclosure requirements, monitoring arrangements and the development of analytic models of market behaviour. Information may allow regulators and market participants to make strategic decisions on the basis of a sound understanding of the environment. The availability of information, however, is not necessarily sufficient for avoiding systemic risk for a number of reasons. First, individual market-players face MORAL HAZARD in that they may be encouraged to behave in a risky fashion by the mere existence of regulators, insurance, lenders of last resort and other aspects of modern regulation and supervision. Thus no amount of information about the potential hazards of particular activities or the environment as a whole may be sufficient to persuade market actors to behave prudently. Second, it may be that the individual disturbance or cumulative weight of multiple disturbances are so large or threatening to vital parts of the system that no amount of

information will provide sufficient warning or stir authorities into action.

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PETER DOMBROWSKI

T

Taft-Hartley Act

The US Taft-Hartley Act, officially entitled the Labor-Management Relations Act (1947), is an amendment to the National Labor Relations Act (NLRA) that was passed primarily to limit trade unions in the United States. The act contains five titles: Title I amended the existing NLRA. Many of the provisions that were contained in the original NLRA were modified and new provisions were added. For example:

- 1 Section 7 of the original NLRA had given employees the right to join unions, engage in concerted activity (for example, strike) and bargain with employers through unions. The Taft-Hartley Act added a new sentence to Section 7 which specifically stated that employees have the right to refrain from engaging in those same activities.
- 2 A set of union 'unfair labor practices' was added, making it illegal for unions to engage in certain activities (for example, engaging in certain types of strikes, coercing employers, discriminating against employees for non-payment of dues).
- 3 Certain employees who had been covered and protected by the original NLRA were removed from the NLRA's protection (for example, individuals defined as 'supervisors' by the act).
- 4 Decertification procedures were added, enabling a group of employees who were represented by a union to revoke that union's representation.

Title II contains provisions that apply to labour disputes that occur during 'national emergencies'. Under these provisions, if the president finds that a strike or lock-out will 'imperil the

national health or safety' (even an otherwise lawful strike), then the president is authorized to apply to have that strike or lock-out enjoined. Prior to the Taft-Hartley Act, the Norris Laguardia Act made it illegal for such strikes to be enjoined. Title III dealt with lawsuits in federal court by and against unions, prohibited certain payments to unions (that is, payments from employers), allowed employers to recover damages caused by certain illegal strikes, amended the Federal Corrupt Practices Act to make certain political expenditures by unions illegal and made it illegal for any person employed by the United States and US agencies to strike. Title IV established a commission (no longer in existence) to study the NLRA itself and other labour-management problems in the United States. Title V states that employees could not be required to work without their consent and also states that nothing in the NLRA makes it illegal for employees to quit their jobs. In addition, Title V contains a separability provision, meaning that if any part of the act were declared 'invalid', the validity of the other parts would not be affected.

The effects of the Taft-Hartley Act have been frequently discussed. Some of the most important were:

- 1 it became more difficult for unions to win the right to represent a firm's employees;
- 2 it became more difficult for unions to negotiate favourable collective-bargaining agreements;
- 3 the economic pressure tactics (for example, strikes, picketing, boycotts) available to unions were restricted;
- 4 it was now possible for unions to be

take-off theory

decertified, thereby losing the right to represent employees;

- 5 individual states were granted the right to pass right-to-work laws (right-to-work laws are laws that outlaw union security agreements).

See also:

bargaining: advantageous factors; labour relations: law; trade unions: unionization

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STEVEN E. ABRAHAM

take-off theory

The concept of take-off is seen frequently in the development literature. In general terms, 'take-off' means simply that a country has entered into a period of modern ECONOMIC GROWTH. However, in its original meaning the concept is more specific.

The take-off theory, also called 'STAGES OF GROWTH theory', was clearly formulated by W.W. ROSTOW (1960). It states that the transition from UNDERDEVELOPMENT to DEVELOPMENT can be best described in terms of a series of steps or stages through which all countries must proceed. The advanced countries had already passed the so-called 'stage of take-off into self-sustaining growth', while the underdeveloped countries (still in either the 'traditional society' or the 'pre-conditions' stage) only need to follow a certain set of rules of development to take off. The principle condition necessary for any take-off is considered to be the mobilization of domestic and foreign savings, in order to generate sufficient investment to accelerate economic growth. The economic mechanism, according to this theory, by which more investment leads to increased economic growth can be best described in terms of the HARROD–DOMAR GROWTH MODEL.

Critics of the take-off theory (like those who support the STRUCTURAL CHANGE theory) claim that, although accelerated capital formation might be a condition *sine qua non* for development, it is surely not the only determinant; institutional and structural factors should be considered as well.

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J.E.C. ENGELBERTS

tariffs

'Tariffs' are taxes that are imposed on traded goods, most commonly imports. As such, tariffs serve as impediments to international trade. Historically, tariffs have been the most important device for regulating trade. This central role was strongly related to their importance as a principal source of government revenue. More recently, as nations have diversified their tax bases away from indirect taxation (tariffs, sales taxes) and towards direct taxes (income), tariffs have come to play a more limited role in both influencing trade and creating revenue. The post-World War II period has witnessed a significant decline in tariff levels due to a succession of negotiations ('rounds') in the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT).

A distinction can be made between protective tariffs (which are taxes imposed on goods which compete with domestic products) and revenue tariffs (imposed on goods which have no domestic counterparts). Tariffs can be distinguished from quantitative restrictions (such as QUOTAS), which influence trade flows by setting specific limits (rather than imposing taxes) on what goods can be imported or exported. There are a considerable number of other protectionist measures, referred to as NON-TARIFF BARRIERS (NTBs), which can affect trade in a variety of ways; these range from health codes to technical barriers. Tariffs may be levied either in an ad valorem fashion (as some percentage of the value of an import) or specifically (some fixed amount per unit such as \$1 per ton of grain). While the nominal tariff on a particular import can be indicative of the level of protection enjoyed by domestic producers (the higher the tariff, the safer are

domestic producers from foreign competition), it is frequently misleading as a measure of protection for finished goods that make use of INTERMEDIATE GOODS that are themselves imported. In this case, the EFFECTIVE RATE OF PROTECTION is a superior measure, because it takes into account the entire tariff structure – that is, it accounts for tariff levels pertaining to every stage of production. Hence finished goods that are protected by tariffs that are higher than those tariffs levied on their inputs (tariff escalation) will find that nominal tariff levels understate their level of protection, while goods that face tariffs on their inputs which are higher than those applied to competing imports will find that nominal tariff levels overstate their level of protection.

The imposition of a tariff on imports of a specific good normally has the following effects on a country not large enough for the imposition to affect its TERMS OF TRADE: it reduces imports of that good, reduces domestic consumption of that good, reduces exports, raises the price of that good in the home market and drives a wedge between the domestic and international prices of that good, reduces overall production in the home country, shifts resources from non-protected industries to the protected industry (that is, increases production of the protected good at the expense of non-protected goods), increases the returns to specific factors employed in the protected industry and could lower the returns to specific factors employed in non-protected industries, earns revenue for the home government, reduces WELFARE in the home country, and reduces global welfare.

The economic welfare losses brought about by tariffs have fuelled the argument for FREE TRADE. However, common welfare arguments in favour of tariffs have come from several fronts: OPTIMAL TARIFFS and domestic distortions. While countries that cannot affect their terms of trade will almost always suffer welfare losses from tariffs, nations which do have such influence over international prices may theoretically be able to improve their welfare by imposing tariffs. The argument here states that nations can raise the prices of their exports

tax competition

relative to their imports because a tariff both reduces the demand for their imports and the supply of their exports. Thus, improved terms of trade would lead to a gain in welfare. This assumes, of course, that other nations will not retaliate. If retaliation occurs, all can lose substantially by imposing tariffs. Furthermore, other countries always lose because of the tariff, which means that while one country may gain by an optimal tariff, the world as a whole stands to lose. The domestic-distortions argument suggests that where MARKET FAILURES have already imposed welfare losses on an economy, further intervention in the form of trade barriers may in fact have a positive impact on welfare (according to the theory of second best – see SECOND BEST, THEORY OF). Governments may, in fact, wish to protect an infant industry (see INFANT-INDUSTRY PROTECTION) that is especially innovative and therefore potentially important to long-term growth, or they may be concerned about the long-term effects of foreign DUMPING. Both problems might be addressed through a tariff. The problem with tariffs in such cases is not that they would be completely ineffective as a solution, but that more direct solutions applied specifically to the economic goals at hand would probably be less distortionary. Since tariffs have broad distortionary effects on both consumption and production, they would be inferior to devices such as taxes and SUBSIDIES applied directly to either consumption or production.

As measures that restrict competition, tariffs (like other barriers to trade) invariably generate sizeable surpluses (that is, rents) which can be captured by parties directly affected by such trade policies. Factors tied to specific industries may attempt to increase their returns by getting tariffs imposed on imports with which they compete. Counter-coalitions may form among individuals (firms in other industries, consumers) who find their income adversely affected by such tariffs. Finally, governments will find their own incentives to supply such policies (revenues, rewards from RENT-SEEKING coalitions). Trade policy then becomes an outcome of the interplay between redistributive coalitions

and governments. Much of the political explanation of tariffs (endogenous tariff theory), as well as other protectionist devices, has been developed within this context.

See also:

countervailing duty; duties; fair trade; import controls; trade policy; World Trade Organization (WTO)

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tax competition

International tax competition occurs if governments reduce taxes to attract internationally mobile capital and skilled labour. It is a consequence of the growing international integration of national economies, although international competition has long had an influence on taxes, particularly in small, open economies. Tax competition is most severe in the case of financial capital. Investors can avoid taxation in their country of residence on foreign-source capital income (for example, interest payments) by taking advantage of bank secrecy laws in foreign financial centres and the weakness of information sharing among national tax authorities. Governments also find it difficult to tax capital income (such as interest) paid to foreign investors. Withholding taxes on these interest payments would reduce foreign investors' after-tax income below the level they could receive in countries that do not levy withholding taxes, thereby either forcing borrowers to offer higher interest rates (to offset the tax) or causing CAPITAL FLIGHT. Withholding taxes on capital income

paid to domestic investors are undermined by the growth of transnational banking and TAX HAVENS, which enable domestic taxpayers to make investments in domestic bonds through foreign intermediaries and thus benefit from the dynamic just described. For example, Germany was forced to withdraw a withholding tax on interest payments in 1989 because investors avoided the tax by routing purchases through Luxembourg. This kind of international tax competition could be prevented only by cooperation between virtually all countries, which would have to agree to share information on capital income payments to non-residents or to impose harmonized withholding taxes. High-tax European countries favoured EUROPEAN UNION (EU) efforts to prevent this tax avoidance by harmonizing withholding taxes, but the governments of countries with large financial services sectors (for example, Luxembourg and the United Kingdom) rejected this measure and have blocked information sharing unless tax havens outside the EU also agree to share information with EU countries' tax authorities.

International tax competition also affects corporate income taxes (similar competitive pressures exist with respect to taxing the income of highly paid, internationally mobile individuals). High tax rates on corporate income can trigger an outflow of investment to lower-tax countries; alternatively, firms could continue to invest but avoid the higher taxes by using income-shifting techniques such as TRANSFER PRICING to declare profits in low-tax jurisdictions. International tax competition could therefore reduce corporate tax revenues and induce governments to cut tax rates and introduce tax incentives. But non-tax reasons for investment often outweigh tax factors and real investment is not as mobile as financial investment. These factors, combined with deficit pressures in most industrialized countries, have helped to limit the impact of tax competition on corporate tax revenues.

International tax competition tends to shift the burden of taxation away from internationally mobile tax bases and towards relatively immobile tax bases such as labour income and

consumption. It therefore undermines redistributive taxation, as wealthier classes generally earn a higher share of their income from capital than poorer classes, which are more dependent on labour income. To the extent that this happens (and it has proven difficult to find conclusive empirical evidence), international tax competition is an international constraint on the traditional Keynesian WELFARE STATE, and can be understood as a manifestation of the growing STRUCTURAL POWER of transnational capital.

Competition for tax revenues may offset some of the impact of the competitive dynamic just described. Governments can try to extend the extraterritorial reach of national taxation by taxing income earned abroad by domestic investors and multinational corporations (MNCs). A high-tax country could do this only if it had strong non-tax locational advantages; otherwise, investors would flee to more favourable locations. A government could try to capture a larger share of the global tax base by limiting the ability of resident taxpayers to shelter income in tax havens and by forcing TNCs to declare a higher share of their global profits within its borders. The United States has taken this approach (for example, by restricting transfer pricing practices) and in so doing has relieved some of the pressure on other governments to cut taxes to attract investment.

Governments have attempted to cooperate to limit harmful tax competition. The EU's voluntary 1997 code of conduct on business taxation called on governments to refrain from offering tax incentives to attract investment, but it has been difficult to reach agreement on which specific measures to prohibit. In reports from 1998 and 2000, the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) tried to develop a consensus to discourage member-countries from offering tax incentives for internationally mobile financial services industries, but it is not yet clear whether countries will accept strict limits in this area (and no measures are yet planned for manufacturing industries). The OECD has threatened non-member tax havens with coordinated

tax havens

sanctions unless they agree to modify their tax regimes, and many of them appear willing to make some of the changes demanded by the OECD. But harmonization of general corporate tax rates was rejected by the EU and the OECD, with the latter favouring competition in this area as a way of improving government efficiency.

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tax havens

'Tax havens' are centres that offer an array of tax and regulatory incentives for non-resident investors and grant complete flexibility to the management of foreign assets. They can be defined as deliberate *state* policies that aim 'to attract thereto international trade-oriented activities by minimisation of taxes and the reduction or elimination of other restrictions on business operations' (Johns, 1983: 20).

Estimates of the total number of tax havens in the world tend to vary. The latest inclusive list contains sixty-eight jurisdictions (Diamond and Diamond, 1998), but the list does not include a number of failed tax havens. By all accounts, tax havens are having huge impact on the world economy. By some estimates, more than half of the world's stock of money passes through tax havens, and about 20 per cent of total private wealth and 22 per cent of banks' external assets are invested in them (Cassard, 1994).

There are as many varieties of tax haven

legislation as there are such jurisdictions. It is common, nonetheless, to distinguish four different classes of tax haven:

- 1 countries or jurisdictions (like Anguilla, the Bahamas, Bahrain, Bermuda, the Cayman Islands, the Cook Islands, Djibouti, Turks and Caicos, and Vanuatu) that have no income tax and where foreign corporations pay only licence fees;
- 2 countries or jurisdictions (like the British Virgin Islands, Guernsey, Jersey, Liechtenstein, Oman and Switzerland) with low taxation;
- 3 countries or jurisdictions (like Hong Kong, Liberia, Panama and Venezuela) where taxes are levied only on internal taxable events, but not at all (or at very low rates) on profits from foreign sources;
- 4 countries or jurisdictions (like the Isle of Man, Luxembourg, Monaco, the Netherlands and the Dutch Antilles, the Austrian Antilles and Singapore) where special tax privileges are granted to certain types of companies or operations.

In addition to these four categories, there are special cases (such as Greece, Jordan, the Philippines and Tunisia) that offer specific legislation to attract regional offices of foreign companies.

The great variety in tax haven legislation is due to a number of factors. First, domestic legislation and legal traditions vary a great deal between one country and another. As a rule, small islands' legislatures find it easier to implement 'liberal' tax laws and strict secrecy codes than their larger brethren. Second, due to the dramatic proliferation of tax havens, many states have opted to specialize in niche-markets and target their financial and tax laws to specific clienteles. Third, geographical location and juridical ties also allow niche-marketing.

Notwithstanding the great variations between tax havens, they tend to share the following attributes:

- 1 Minimal or non-existent personal or corporate taxation.
- 2 Effective bank secrecy laws. Quite often

bank or state officials are barred by law from disclosing the origins, character and name of holders of funds.

- 3 Few (preferably no) restrictions or regulations concerning financial transactions and protection of the secrecy of transactions.
- 4 Possess political and economic stability – hence the preferred jurisdictions are dependencies of large, prosperous and stable states.
- 5 Supported by a large international financial market or alternatively equipped with sophisticated information-exchange facilities and/or within easy reach of a major financial centre. Gibraltar, for instance, has invested heavily in its communications infrastructure.
- 6 Not tainted by scandals, laundering or drug money.
- 7 Having agreements with major countries to avoid double taxation and regulation.

A number of tax havens (such as Hong Kong and Freeport in the Bahamas) have now branched out and are used as manufacturing centres or EXPORT-PROCESSING ZONES (EPZs). Many tax havens have also become important players in the lucrative market for FLAGS OF CONVENIENCE (FOCs) and aircraft-leasing: these include the Bahamas, the Cayman Islands, Luxembourg, the Marshall Islands, Panama and Vanuatu.

Contrary to conventional wisdom, the leading industrial countries maintain an ambiguous attitude towards tax havens. Some of the leading tax havens, such as the British Virgin Islands, the Cayman Islands and the Channel Islands, are dependencies of the United Kingdom. Indeed, in 1990, the UK government commissioned an accountancy firm, Coopers & Lybrand, to carry out a review of offshore regulation in several UK territories with a view to enhancing their international competitiveness. As the *Economist* noted:

The British government tolerates the offshore financial industry on the assumption that it brings more money into Britain by channelling more expatriate and foreign wealth into London than is taken out by people working tax dodges.

(*The Economist*, 1996)

The US Treasury was traditionally hostile to tax havens. Indeed, Walter and Dorothy Diamond argue that the great impetus for the proliferation of tax havens was due to the United States Revenue Act of 1962. The amendments to it were designed to curtail the use of tax havens by US companies, but they have encouraged their use throughout the world. Lately, however, there are signs of shift in policy. On one hand, the US Treasury has been the most persistent in seeking to raise the veil of secrecy surrounding financial activities in tax havens. At the same time, Hines and Rice (1994) argue, the principles of double-taxation treaties ensure that US Treasury receipts tend to increase rather than decrease when US corporations shift to tax havens. While they concede that US and foreign investment in tax havens has an uncertain effect on US tax revenue, they maintain that it is nonetheless in the interest of US Treasury to encourage US firms to locate to tax havens.

Tax havens are central to the functioning of the offshore economy (see OFFSHORE FINANCE). Under EUROMARKET provisions, offshore finance is applicable only to transactions among non-residents. Tax havens provide a cheap and easy way by which resident companies (or individuals) can masquerade as non-residents for euromarket purposes, hence the strong symbiotic relationship that has evolved between the tax havens and the euromarket. In addition, tax havens permit companies to syndicate their profits worldwide in zero or near-zero regulation jurisdictions. Tax havens are used, therefore, to accumulate dividends, interest and other income. They are also used by multinational enterprises (MNEs) as a central point for handling paperwork and for preparing and processing trade documents. Many companies depend on tax havens for passage of title of goods in order to minimize red tape.

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tax holidays

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tax holidays

A 'tax holiday' is defined as total or partial exemption of new or expanding firms from direct TAXATION for a specified period. It is one of the most attractive types of fiscal incentive schemes. For an initial period, no business taxes are payable by the industries that have been chosen. Even after this period, most countries allow the losses made in the tax holiday to be offset against profits. This incentive is given for building up an industrial base and promoting EXPORT-ORIENTED INDUSTRIALIZATION (EOI) or IMPORT SUBSTITUTION

INDUSTRIALIZATION (ISI), or for helping infant or strategic industries. Countries often seek to outdo each other in offering foreign investors various tax-holiday schemes.

SUPRIO GHOSH

tax policy

Tax policy has to take care of three important objectives: (1) revenue mobilization, (2) income distribution and (3) stabilization. While both neo-classical and modern economists agree that tax policy has a crucial role to play in any growth-oriented economy, they assign different roles to taxation. The neo-classical economists have argued that any tax policy is to be judged by its revenue-yielding capacity (see NEO-CLASSICAL ECONOMICS). The modern economists, however, emphasize taxation as an instrument for allocating resources to different sectors of the economy. Needless to say, in any developing economy one has to effectively combine the two approaches and build up a tax structure which is not only revenue-generating, but also helpful in providing incentives for physical resources to move from less productive to more socially desirable and productive lines of development.

In developing economies, both direct and indirect taxes are necessary for mobilizing resources. Direct taxes are necessary from the equity point of view, but too much reliance on direct taxation may not serve utility. Even though a progressive tax has a lower marginal social cost than a regressive tax (see TAXATION, PROGRESSIVE; TAXATION, REGRESSIVE), after the tax has reached a certain optimal level, it is better to use a second tax which is less desirable than the first, because after this level, the disutility of the progressive tax becomes greater than that of a commodity tax. In developing economies, commodity taxes have been considered more desirable from the angle of providing incentives for private-capital formation. To accelerate the pace of economic development, the tax system must have both depth and range.

Supply-side economists have shifted the emphasis of tax policy from aggregate demand-management to the micro-motivations for productivity (see SUPPLY-SIDE ECONOMICS). The central tenet of this philosophy is the responsiveness of work, productivity, savings and investment to after-tax rewards. Higher tax rates are opposed because they discourage economic activity. According to Arthur Laffer (the 'Laffer curve'), there is a close relationship between tax rates, revenue and productivity. When the tax rate is 100 per cent, all revenue ceases: people will not work for nothing. On the other hand, if the tax rate is zero per cent, there is no revenue for government and thus for the creation of public goods. Somewhere in between there is an optimum point at which tax rates will produce the desired revenues. That point is variable but, in a democratic system, 'it is where the electorate desires to be taxed'. Too heavy a tax burden can lower the incentive to work and reduce revenues. Supply-side economists believe that a permanent cut in tax rates (as opposed to rebates, piecemeal concessions and low-income credits) powerfully stimulates the supply of goods and services, and increases the incentive to produce, save and invest. Their main contention is that people do not work to pay taxes. Laffer developed the concept of the 'tax wedge'. This is the gap that the government, through its power to tax, introduces between what an individual gets for working and what that individual is allowed to keep.

Of late, the idea of Negative Income Taxation (NIT) is gaining ground in many countries as a means to reduce poverty. In NIT thinking, a certain level of income is defined as the poverty income-level. Tax is imposed on incomes higher than this level; tax is nil at the poverty income-level: at lower than poverty income-level, an amount is paid to the earner that is equal to the difference between the poverty income-level and the actual income. The NIT is seen as an important way to lower the level of poverty. Some economists argue for a 100 per cent NIT, which means that other supporting welfare programmes would not be necessary any longer for the poor. The payment to the poor would preferably be in cash.

MILTON FRIEDMAN prefers a 50 per cent NIT. The NIT policy, however, may kill the incentive to work on the part of the poor and there may also be misreporting of income.

The problem of tax evasion is gaining importance in both developing and developed countries. Hence, the framing of tax policy involves the determination of an optimal level of evasion – that is, the level at which the marginal cost and the marginal benefit of reducing tax evasion are equal. A policy which is aimed at completely eliminating tax evasion may be inefficient because the marginal cost of eliminating evasion may be greater than the marginal benefit to be derived from its elimination. The administrative and political costs of checking evasion may be considerable.

Tax policy has had to take into account not only the domestic economic environment, but also the international political-economic context. The increasing instability of the international financial system has been attributed, to an extent, to currency speculation (particularly in the South-East Asian economies) and this has once again brought into focus James Tobin's prescription of levying a tax on foreign-currency transactions (the 'Tobin tax'). Such a tax on foreign-exchange transactions should check uncontrolled speculation. Proposals also exist to tax emigrating high-quality labour of poor states, so as to reduce brain-drain and earn extra revenue. Hence, tax policy is dynamic: it must take into consideration changing global conditions.

See also:

taxation, indirect; value added tax (VAT)

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taxation, indirect

The distinction between direct (for example, income) and indirect (sales or value-added) taxation is widespread, but fairly loose. Most authors relate this distinction to the possibility of tax shifting. Those who pay a tax are not necessarily those who really bear the burden. The statutory incidence of a tax indicates who is legally responsible for transferring the tax to the public purse. But prices may change in response to the tax. Therefore, knowledge of statutory tax incidence does not say much about who really bears the burden of a tax. In contrast, the *economic* incidence of a tax is the change in the distribution of private real income brought about by the tax. The extent to which statutory and economic incidence differ is the amount of tax shifting.

Some dub taxes direct if they are shifted and indirect if they are not shifted. This criterion encounters serious problems, however. In practice, it is not possible to determine with certainty whether or not a tax is shifted.

Different models of price determination may give quite different answers to the question of who really bears the burden of a tax.

In the past it was often assumed that income and wealth taxes could not be shifted, and that consumption taxes could be shifted. Nowadays, however, this assumption is generally rejected. There are many examples of tax shifting, including employees shifting wage-taxes to employers and producers shifting profit-taxes to customers. In addition, the possibility for sellers to shift consumption-taxes to consumers is not unlimited.

M. PETER VAN DER HOEK

taxation, progressive

The relationship between taxes and income can be ‘progressive’, ‘proportional’ or ‘regressive’ (see TAXATION, REGRESSIVE). A progressive tax is a tax in which the proportion of income paid in tax increases as income rises. Confusion may arise because some people think of progressive taxes in terms of increasing marginal tax rates (the change in tax paid with regard to a change in income); however, progressive and regressive taxes are defined in terms of the average tax rate, rather than in terms of the marginal tax rate. The average tax rate is the ratio of taxes paid to income.

Rising marginal tax rates are not necessary for a tax to be progressive. A ‘Bentham tax’ is a tax with a constant marginal rate and a fixed tax threshold. Assume a Bentham tax with a marginal tax rate of 50 per cent and a tax threshold of 10,000 euros. Table 5 illustrates this simple tax structure.

Table 5 Tax liability under a Bentham tax (marginal rate: 50% threshold: 10,000 euros)

Income	Taxable income	Tax liability	Average tax rate (%)
20,000	10,000	5,000	25
50,000	40,000	20,000	40
100,000	90,000	45,000	45
200,000	190,000	95,000	47.5

Because the average tax rate increases as income rises it is a progressive tax, even though the marginal tax rate is constant at 50 per cent. This is the result of combining the constant marginal rate with a tax threshold. The threshold's significance decreases as income rises.

In most countries, the income tax shows rising marginal tax rates, which makes the tax more progressive than a Bentham tax. However, the income tax is less progressive than statutory rates suggest, because exemptions and deductions reduce the proportion of income that is subject to tax. Exemptions apply to specific categories of income that are not taxed, whereas deductions apply to specific categories of expenditure that are not taxed. Evaluating the progressivity of a tax thus requires information about the composition of taxpayers' incomes and how they spent their money.

Exemptions and deductions are called 'tax expenditures'. They have the same effect on the budget balance as 'direct expenditures'. Tax expenditures reduce tax revenues, whereas direct expenditures increase spending.

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taxation, regressive

The relationship between taxes and income can be 'regressive', 'proportional' or 'progressive' (see TAXATION, PROGRESSIVE). A regressive tax is a tax in which the proportion of income paid in tax decreases as income rises. Confusion may arise because some people think of regressive taxes in terms of the marginal tax rate, which is the amount of tax paid on the last unit – for example, a euro – of income. However, regressive and progressive taxes are not defined in terms of marginal tax rates, but in terms of the average tax rate. The average tax rate is defined as the total taxes paid divided by total income.

Assume three taxpayers: A with an income of 10,000 euros per year, B with an income of

20,000 euros per year and C with an income of 30,000 euros per year. Now consider a tax system in which each taxpayer is assessed 1,000 euros per year. This is a poll tax (or head tax), under which each person pays the same amount of tax. A would pay 10 per cent, B would pay 5 per cent and C would pay 3.3 per cent of their respective incomes. This outcome is highly regressive because the tax takes a decreasing proportion of income as income rises.

Examples of regressive taxes are excise taxes on alcohol, tobacco and petrol. The reason is that these commodities account for greater proportions of expenditure by poorer families than richer ones. Similarly, a general sales tax is regressive because lower-income groups tend to spend a larger proportion of their incomes than higher-income families do.

M. PETER VAN DER HOEK

Taylorism

The term 'Taylorism' refers to the paradigm of workplace organization (or 'scientific management') associated with Frederick W. Taylor (1911). Taylorism postulates that complex labour processes should be organizationally fragmented into the individual movements required to produce a product and the individual worker should specialize in one of these movements/tasks, where they were previously engaged in many or all movements (as in craft production). For example, where two workers had shovelled and pushed a cart, one would shovel and the other push. Apart from the economies accruing from the division of labour as such, Taylor discovered that this fragmentation increased the possibilities for management to apply scientific methods to analyse and reorganize production so as to increase the *intensity* of work. This was because the set-up of the production process could be optimized through 'time-motion studies'. Most importantly, since the motion of workers was now available for observation, measurement and

Taylorism

control, the Taylorist set-up facilitated a closer discipline of workers.

Taylorist management proved to be very well suited for the capital-intensive, product-specific, large-scale industrial technology of the twentieth century. It was extended through Fordism, which connected scientific management with dynamic machinery such as the conveyor belt, and became the paradigmatic way to organize production until the 1970s.

Taylorism is held to increase social control, empty work of meaningful content and generate ALIENATION. The labour militancy and wildcat strikes of the late 1960s and early 1970s were, in part, provoked by these aspects. On the other hand, Taylorism generated tremendous increases in productivity and provided the material basis (though not the sufficient institutional basis) for mass production, mass consumption and what regulation theorists call an 'intensive regime of accumulation' in the post-World War II period (see REGIME OF ACCUMULATION (ROA); REGULATION THEORY). Hence it is seen to have provided the material basis for the Keynesian WELFARE STATE.

Taylorism is an important concept in international political economy (IPE) for those who work within the historical-structural perspective associated with ROBERT COX. Asserting the importance of the specificity of production in particular politico-economic eras, they argue that Taylorism provided the economic substructure of post-war US hegemony (the *PAX AMERICANA*). The pragmatic Fordist capital-labour accord was pioneered by the United States and was then successfully projected to the Western world as a whole as a response to COMMUNISM and anti-capitalist strands of socialist politics. Hence, HEGEMONY could be forged consensually within states and between states, so as to generate a transatlantic, Western 'organic alliance'.

The adequacy of Taylorism and Fordism as production paradigms has, however, been questioned in light of the 'microchip revolution' and 'cybernetic automation'. Innovations have arguably generated a technology based on fundamentally different principles, which fa-

vours 'general purpose machines' that in turn require a smaller, multitasking, flexible and more skilled workforce (known as 'flexible specialization' or 'POST-FORDISM'). On the other hand, it is also arguable that this new technology may be profitably organized according to Taylorist principles, since information technology can intensify surveillance. Hence, it may survive the 'third industrial revolution' (see INDUSTRIAL REVOLUTION, THIRD). Its relevance seems to remain particularly in the consumer service sector and in manufacturing in peripheral EXPORT-PROCESSING ZONES (EPZs).

See also:

exploitation; surplus value

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technological capabilities

The ability to use TECHNOLOGY depends on factors which may be directly connected with the technology itself or may result from the context of its deployment. The technological capabilities of a particular actor or group reflect the political economic context, as well as potential capabilities. Access to technology does not necessarily indicate specific technological capabilities and may be blocked by extra-technological factors. The technological capabilities enjoyed by individuals are often linked with those of their employer; those of the company in turn relate to the technological capabilities of the STATE; finally, these must be seen as contextualized within the general level of social technological capabilities at the global level.

Individuals

Human beings are physically and mentally equipped to potentially use any available technology that has been designed by other humans. However, the use of technology is actually distributed extremely unevenly across the global political economy. This unevenness contributes to and reflects other disparities, perhaps most notably disparities in wealth. This implies that there are intervening factors between the potential ability to utilize a specific technology and the actual attainment of technological capability. LEWIS MUMFORD suggested the first major technology that humans developed was language, enabling groups to coordinate activities and share or transfer discoveries. Language enabled the dissemination of advances, but also the pooling of experience to further enhance technological development. Today, the importance of language to technological capabilities remains crucial: without being able to understand instructions, no individual can easily adopt a particular technology. The operating languages embedded within software-based technologies have further emphasized the importance of specialized language competencies for the attainment of technological capability.

However, language itself may not be sufficient; without understanding the shared experiences from which a technology developed, potential users may not fully appreciate the uses to which innovations can be put. Furthermore, given the socially embedded character of TECHNOLOGICAL CHANGE, what is regarded as useful in one location may be less useful, or not address immediate needs, elsewhere in the global system. Successive technologies build on their precursors; therefore, methods of use often implicitly assume a knowledge of previous stages. Thus, without the background skills required to understand any new technology, individuals may still not be able to develop the capabilities for which immediate training is available. As the skills needed in order to master certain technologies change, so the required educational background may shift and leave some who are adept in previous technologies less able to develop new capabilities. Though all humans have the *potential* to develop these capabilities (provided they develop the necessary intellectual skills through socialization, education and training), barriers remain to such attainment, ranging from difficulties of poverty and malnourishment, to the global pattern of employment and distribution of wealth.

Companies

Though individuals carry the potential to develop any technological capability, the debate around technological capabilities conventionally privileges the company as the locus of attainment. Companies are where technology is deployed to produce products or services and, as such, their capabilities are more easily assessed and compared. Companies, driven by the requirement for PROFIT MAXIMIZATION under capitalist market relations, seek to innovate where such innovation will enable them to successfully compete against other market actors. Only those technologies which represent an opportunity for realizable profit will therefore be adopted. Indeed, a company may not adopt a new technology because the advantage that could be gained from retooling

technological capabilities

and reorganization does not outweigh the costs of these changes within its given investment cycle. The uptake of technology is therefore usually linked to the returns that are demanded from capital investment: a lower required return may allow incremental technological changes, whereas demand for a high return may limit investment to larger leaps in technological capability.

In the past, when technological development was slower, technological lags might allow companies to survive without 'state of the art' technological capabilities. In the newly emerging post-industrial or information economy (see INFORMATION SOCIETY/ECONOMY; POST-INDUSTRIALISM), the ability to ignore innovation is disappearing. With some exceptions (primarily those companies whose market is based on specific and often 'traditional' technological capabilities), most companies recognize that competition requires them to keep up with technological advances. Many have started to increase their dependence on contracted suppliers, gaining the advantages of new technologies through outsourcing to innovative suppliers – switching suppliers when a new innovation makes another supplier more technologically adept. Additionally, the development of supplier networks, held together through contractual relations, may enable the central company to control the diffusion of its suppliers' technology, while carrying less of the risks involved with RESEARCH AND DEVELOPMENT (R&D) expenditure. Thus, while in the past a company's technological capabilities were important for gauging its market position and competitiveness, companies can now through contracting retain their competitive advantage while their own technological capabilities lag, though they will still require sufficient knowledge of such capabilities to judge their contractors' performance.

Nevertheless, in the context of the emerging network company, many innovations and technological advances are still the result of the actions of company-based R&D departments. One of the central arguments used to justify INTELLECTUAL PROPERTY RIGHTS (IPRs) is that the development of new tech-

nologies will only continue by ensuring those who innovate control the results of such innovations as property. However, where such technologies have competitive potential, treating them as intellectual property may in the short run slow down their diffusion. Thus a company may be able to fortify its competitive position by the protection of the intellectual property within its technological capability, but, while such competitive advantage may be extremely beneficial in the short term, new innovations and the possibility of reverse-engineering recent innovations ensures that technological advantages are generally short-lived.

States

Ronen Palan and Jason Abbot (1996) and others have suggested that the global system is increasingly inhabited by COMPETITION STATES, revealing the enduring appeal of some sort of MERCANTILISM for policy-makers. State governments have always recognized that the overall technological capability of companies within their jurisdiction has an effect on the power resources they can draw on. This has led to widespread support for basic science as the root of many technological advances, because such research has not been well-supported by markets. Furthermore, states have self-avowedly developed intellectual property systems to support innovators, thereby protecting their most innovative sectors and ensuring powerful technologies came under the control of their nationals. The Venetian state protected glass-blower's skills through proto-patents in the sixteenth century; in the nineteenth century, the non-recognition of foreign intellectual property rights by the United States allowed the 'theft' of imported technologies by US companies – more recently, US law has developed protection for microchip architecture.

However, since the TRADE-RELATED INTELLECTUAL PROPERTY RIGHTS (TRIPs) agreement, protection of IPRs between countries has become more robust, lessening the ability of competitors to adopt current technologies without recourse to intellectual property legis-

lation. Both the United Kingdom and the United States partly based their early developmental strategies on the non-recognition of foreign intellectual property. Thus, domestic companies were able to 'steal' innovations with impunity and those non-national companies wishing to protect their innovations were required to reveal them through the domestic patent procedure. With the formal internationalization of patent regulation, the TRIPS agreement has closed off this strategy for states that are currently trying to develop their national technological capabilities. These states may increasingly be left as the passive recipients of TECHNOLOGY TRANSFER, dependent on the operation of the international division of labour (see DIVISION OF LABOUR, INTERNATIONAL).

Robert Vernon (1971) developed the PRODUCT-CYCLE MODEL to explain the diffusion of technology throughout the global political economy, suggesting that there was a TRICKLE-DOWN of technological capabilities. As the rich and advanced states moved beyond any particular technology (which is to say that it became a commodity technology rather than an innovative one), so its production was moved to cheaper labour sites that could retain some of the cost advantages originally brought by the innovative nature of the technology or process. Through LICENSING agreements or the attraction of FOREIGN DIRECT INVESTMENT (FDI), LESS-DEVELOPED COUNTRIES (LDCs) were able to capture technologies that, while advanced relative to their own capabilities, were semi-obsolete in the advanced countries. This contributes to and is part of the international division of labour, which reinforces the distinction between states with high-technological capabilities and those that lag at various distances behind the leaders in any particular field.

The development of technological capacities has become one of the key areas of concern for the competition state. Some writers have suggested that the ability of certain states to encourage and foster continued innovation is based on their national systems of innovation – networks of research and governmental sup-

port that have engendered a momentum behind innovation. Others have looked to problems of IPRs and the control of technologies by MULTINATIONAL CORPORATIONS (MNCs) to explain the technological gap between the advanced states and others in the global political economy. More generally, DEPENDENCY THEORY suggests the structure of the global capitalist system itself produces the continuing DEVELOPMENT OF UNDERDEVELOPMENT – the (re)production of a global technology gap. Furthermore, though capabilities may reflect the efficacy of the particular national system of innovation, the role of the MILITARY-INDUSTRIAL COMPLEX (MIC) should not be discounted.

The US Department of Defense has the world's largest R&D budget, but many of the technologies originally developed for military purposes have had widely beneficial effects through their commercial diffusion. Perhaps the most pervasive recent example is the internet, originally developed to ensure that lines of communication would survive nuclear attack. Conversely, the Soviet military research establishment, completely separated from the civilian sector, did not transfer technological developments effectively into marketable advances. Eventually, the Soviet military and civilian industries were unable to keep up with the information revolution taking place in their superpower competitor, with dire consequences for the Russian economy, especially once the economy was opened up after the fall of the Soviet system. Elsewhere, in the United Kingdom for instance, expenditure on military research has been at the expense of support for national technological capabilities in commercial sectors. While the military has enabled the US government to support and fund many breakthroughs in the United States, other states have been less successful at combining military R&D with commercial exploitation of the resulting innovations.

Social/global capabilities

At the systemic level, it is very difficult to generalize about the technological capabilities

technological change

of the global political economy. In one sense, as with the notion of individual technological capabilities, it is possible to accord to the system the capabilities that are enjoyed by the most advanced and technologically adept groups. Thus it could be argued that the global system is developing vast informational capabilities and is becoming a global information society. But, when the actual distribution of technology is examined, the vast bulk of the world's population still works on the land, so in a sense the global system is still essentially at an agrarian level of generalized technological capability. So while the technological capabilities of the global population are potentially at the level of the richest and most advanced, many are really lagging far behind. Why this is and what might be done to alleviate the technological deficiencies that characterize the bulk of the world's population is a central problem for international political economy (IPE), as is the more problematic question: Is the maximization of technological capabilities an unambiguous good?

See also:

appropriate technology; competitiveness of nations; industrial policy; List, Friedrich; Rostow, W(alt) W(hitman)

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CHRISTOPHER MAY

technological change

TECHNOLOGY can be understood as the means by which human beings attempt to manipulate the environment or mediate its limiting effects on their behaviour. It can, but need not, involve the application of scientific reasoning to produce solutions to problems, such as those posed by transportation, communication or production. Throughout human history technologies have been changing and the effects of these changes have often had far-reaching implications for both politics and economics. In fact, it is debatable whether there have ever been human societies without technologies of some sort – simple stone tools are found associated with the very earliest (Lower Palaeolithic) human communities. However, it is not true that only humans employ technology: some primates use tools, and thus technologies, of their own manufacture. The view that a unique feature of humanity is 'Man the Tool-maker' is, therefore, incorrect.

The information available through historical, anthropological, archeological and linguistic research means that much is known of the early development of technologies. The conventional, but not strictly accurate, division of prehistory is the 'Three-Age system', which is based on technological change. This divides preliterate (that is, prehistoric) societies into those that use only stone tools (Stone Age), those that use stone and copper-alloy (Bronze Age) and those that also employ iron (Iron

Age). These stages form a chronological sequence broadly approximating to the sequence of prehistoric technological development, which can be subdivided on the grounds of further technological and economic changes. The most significant of these subdivisions is probably the beginning of farming and the manufacture of ceramics: the Neolithic (or New Stone Age) Period. With the emergence of the earliest regularly governed political units ('chiefdoms'), also in the Neolithic Period, technological development gathered pace. By the time of the earliest cities and states, in the Bronze Age, a wide range of technologies for food-production in metal, wood, bone and ceramics are known. A revolution in communications technology (writing and record-keeping) accompanied the emergence of the STATE, and led to the possibility of storing detailed information (including technological data) over generations and its transmission over long distances. The growth of states and empires helped to disperse these technologies much more widely, but technological 'diffusion' appears to have played a much less important role than was once thought likely. Rather, new technologies tended to be 'independently invented' in many different locations at broadly the same time. Thus, for example, iron-working did not develop in a single centre and 'diffuse' to the rest of the world: it was independently invented in several places and at several times in history.

Developments in two areas require special attention: in the Greek and Roman world (from the period of Classical Greece in the fifth century BC onward), the development of systematic scientific and philosophical enquiry led to an enhanced rate of technological change. Rapid technological development also occurred in China, where similar intellectual traditions developed somewhat earlier. The economic consequences of these technological changes are currently a subject of debate. It may be that imperial China and Rome produced 'proto-industrial' economies. The latter are broadly definable as economies in which industrialization is occurring, but in which an industrial revolution has not taken

place. Certainly there are indications of very large-scale production, organized in a systematic fashion and linked to regional-level distribution networks. Although many of these technological advances were lost in Western Europe after the end of the Western Roman Empire in the fifth century AD, this loss was not absolute. Much of the fabric of local society and economy (and thus technologies) continued into the fifth-seventh centuries with few changes. The 'barbarians' (mostly Germanic tribes from beyond the Roman frontier) who invaded the (already collapsing) Empire had a far less destructive effect on its infrastructure than was once supposed. For example, water-mills (introduced by the Romans) were still being made and their technology still developing in the sixth and seventh centuries. In the eastern part of the Roman Empire (which, for this historical period, is now known as the Byzantine Empire), the Roman state survived for centuries. There, Roman technologies and Roman scholarly tradition which, in part, produced them were preserved and new technological innovations took place. These technologies (and this tradition of scholarship) both partly passed into the Arabic world, in the course of the Islamic conquest of much of the Byzantine world during the seventh century and later. This laid the foundations for medieval Arabic scholarship, which maintained – rather than expanded on – 'Roman' (Byzantine) technology through the European Middle Ages. Meanwhile, in medieval Western Europe, most technological innovations were concerned with farming, construction and seafaring, with little attention to deliberate scientific enquiry. Although China also maintained its early technological advances into this period, the focus of global technological change shifted decisively to Europe with the fifteenth-century Renaissance. This 'rediscovery' of Roman and Greek science and learning coincided with a new phase of rapid technological development. Probably the most important of these technological developments was the invention of printing. This led to the rapid spread of new innovations and the far greater availability of existing books. In turn, this

technological change

partly led to an increasing rate of scientific discovery, sometimes with technological consequences, in the sixteenth, seventeenth and eighteenth centuries.

During these centuries, European states developed worldwide empires, dependent on efficient communication, transport and military technological advantages over local peoples. In the later eighteenth century, another major change occurred. This was the application of scientific principles to production and the use of new productive technologies – for example, the blast furnace. These played a central role in the transformation of the Western European economies (beginning with the British economy) by the INDUSTRIAL REVOLUTION of the late eighteenth century. A range of factors, including the increased scale of society, its demands for consumer products, inter-firm economic competition and the potential for rapid wealth-generation then led to an increasingly fast rate of technological innovation during the nineteenth century throughout Europe and in the European empires overseas. This was accompanied by a revolution in transportation, through the development of steam-powered land (and later sea) travel. Steam was used to power factories and in other ways (such as for water-pumps) to assist in the extraction of raw materials and in manufacture. This use of mechanical power was perhaps the most significant aspect of technological change, in relation to the industrial revolution, but it was merely one of many related developments at this time. Simultaneously, production technologies (especially in heavy industry) were constantly being refined and modified and new technologies developed for the extraction of raw materials and for large-scale manufacture. This led to an unprecedented scale and rate of production. The ability to produce synthetic raw materials was developed and production of these was begun. These changes were unparalleled in any other state or society and the industrial revolution is usually considered a unique historical change. Parallel to these economic changes, increased governmental and private resources were devoted to both technological and scientific

research. This led to a wide range of technological changes, including the emergence of modern medicine and hygiene. It also led to the invention of yet more new communication technologies: first the telegraph and then the telephone and means of recording, notably photography and the typewriter. In the early twentieth century, the invention of air transport and wider use of steamships enhanced global communications, now essential given the global scope of European empires and economic systems.

Technological change also has its negative consequences. It facilitated war on a global scale and military competition prompted the invention of new military technologies, such as the machine gun in the nineteenth century; the military aircraft, poison gas and the armoured tank in World War I, and massed air bombardment and ultimately the atomic bomb in World War II. New communications technologies were still being developed: radio, cine film and television were all developed in the later nineteenth century and were thus in existence before World War I. However, radio and film came to play an even greater role after 1918, and television was not widely available until after World War II. These new technologies enabled the growth of global cultural characteristics, while the subsequent growth of computer technology and electronic communication led to the emergence of new forms of economic and social organization (such as global financial markets) and the near-instantaneous transmission of information worldwide. Technological change continues today, perhaps at an increasing rate. Whether or not these changes represent ‘progress’ is an issue that has, however, been much debated.

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KEN DARK

technological policy

'Technological policy' can be defined as a set of public interventions designed specifically to influence the speed and direction of innovation in an economy. It is linked with science policy, but whereas the latter aims to increase knowledge through basic scientific research, technological policy is concerned with the application of that knowledge for the production of goods and services. In economic theory, public intervention for technological improvement is commonly justified with reference to the fact that the market for innovations is prone to widespread imperfections. However, theory has little to say about the specifics of policy design and implementation. Empirical studies on the subject are more insightful, but their findings tend to be highly context-specific. There are no best-practice models and general guidelines that policy-makers can usefully apply.

The broad rationale for technological policy is well established. First, there are widespread problems with the appropriation of the benefits of new knowledge by the party that makes the investments needed to acquire it. An effective patent regime and a well-functioning legal system to enforce it can alleviate this problem. Second, technological effort is often subject to ECONOMIES OF SCALE. In many cases, new

knowledge becomes substantially useful only in fairly large amounts. The required investment outlay and risk may therefore often exceed the capacity of individual private investors, necessitating public action to help mobilize sufficient resources and decide which industries and projects should receive priority in the research effort.

The scope of technological policy differs substantially across countries. Some countries emphasize policies designed to influence the creation of new technologies. This is grounded in the conception that technological progress proceeds in essentially linear fashion from basic scientific discovery through innovation to widespread commercial application. France, the United Kingdom and the United States are the most outspoken followers of this 'mission-oriented' model.

In contrast, other countries aim for rapid commercial adoption and application of new technologies through demand-stimulating incentives. Germany, Japan and Sweden are leading exponents of this 'diffusion-oriented' model. This approach is based on the notion that the creation and adoption of new technologies are part of an interactive process in which the stimulating effects of enhanced demand for new technologies on their supply are as important as the effects of supply on demand. Increased demand for new technologies is likely to speed up innovation by making RESEARCH AND DEVELOPMENT (R&D) more profitable. Moreover, rapid adoption of new technologies tends to give rise to complementary efforts needed to ensure their productive use – for example, through the mastery of new skills and the development of specific improvements by equipment manufacturers in response to feedback from users.

Diffusion-orientation has also been strong in the technological policies of the industrializing countries in East Asia that are engaged in rapid technological catch-up (especially Singapore, South Korea and Taiwan). Here, technological progress has come primarily from accessing technologies that have already been developed elsewhere and deploying them in a new context. Technological policies in these countries have

been aimed primarily at stimulating the acquisition of local capability to make sound choices about which innovations to adopt, guiding their transfer and assimilation, ensuring their effective use by stimulating widespread investment in applied adaptive R&D, and promoting technical education and training. Technological policy in other parts of the developing world is generally less developed.

Although some policy instruments are primarily supply-oriented, while others are aimed more at stimulating demand, a clear distinction is impossible. Several policies influence both technology supply and technology demand through the interaction of the creation, diffusion and adoption of technology.

The main policy instruments that primarily affect the creation of technology are public funding of R&D and institutional research facilities. In broad terms, public financing of defence-related basic research and the R&D for other public sectors that is conducted by universities and/or public laboratories has been particularly strong in the mission-oriented countries. In addition, their governments finance much defence-related research in the private sector. The governments of the other economically advanced countries also spend heavily on basic research and on R&D for public sectors such as infrastructure and health, but defence takes a smaller slice. Public financing of civilian research conducted by the private sector has received less attention in all advanced (and also developing) countries, but there is an increasing interest in funding such activities.

On the demand side, there are five major mechanisms. A widely used instrument is financial subsidies for the adoption of new high-tech technologies – for example, in the form of tax concessions, subsidized loans and depreciation allowances. Japan and many developing countries have employed such incentives. Another major instrument is the provision of information concerning new technologies through pilot demonstration projects and forums such as trade fairs, as used in some European countries and the United States. Government-mandated TECHNOLOGY TRANS-

FER from abroad has been common in the East Asian industrializing economies, Japan and many LESS-DEVELOPED COUNTRIES (LDCs). Government procurement has been important in the defence sector, especially in the United States but also in several other countries. Finally, technical standard-setting is an important mechanism in all economically advanced countries. It facilitates harmonization and reduces uncertainty concerning the performance of new equipment.

Patenting is another important policy instrument, particularly for the economically advanced countries. This influences both supply and demand of innovation, and it does so in opposing ways. The interests of innovators are served by strong protection, while the benefits arising from rapid diffusion of a new technology are best promoted by a relatively loose protection regime.

Little systematic evidence exists about the effectiveness of the different policy instruments. In any case, success appears to depend more on the specific way in which instruments are designed and implemented than on the choice of policy tool as such. The specific nature of the intervention must be attuned to a country's stage of socioeconomic development. A good example is the property rights regime adopted by Japan and Taiwan at an earlier stage of industrialization. Rather than adopting a full-blown patenting regime, they introduced 'utility models' which extended a short period of protection for incremental innovations made by companies on the shopfloor. They did this in recognition of the fact that informal adaptations are a more important source of technical advancement in LDCs than formal R&D (Ranis, 1990).

The results of technological policy also depend on the coherence between different policy instruments used. Together, they must create synergy between the technological efforts undertaken by private companies, science and technology institutions, universities and bodies concerned with standards and metrology, which together make up a country's national innovation system. Finally, a socioeconomic context conducive to innovation is

crucial. Without competition and industrial/trade policies that promote innovation and learning, technological policies can only have a limited impact.

See also:

competition state; developmental state

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HENNY ROMIJN

technology

'Technology' is now an imprecise term used in a number of ways by political economists and other social scientists. Whereas in the nineteenth century, 'technology' referred quite precisely to the application of the 'practical arts' to economic activity, its usage has widened considerably in the twentieth century. Sometimes the term is used to refer to the actual machines used in a specific process: technologies are grouped by their use – for instance, 'information technology' or 'manu-

facturing technology'. However, technology has also come to refer more generally to the set of skills and practices characteristic of a particular group, society or civilization. This leads to an understanding of TECHNOLOGICAL CHANGE as a series of stages through which societies pass – from primitive, through early tool-making, until industrialized or even post-industrial societies are reached. Technology may also refer to specific modes of organizing activities: factories, networks, bureaucracies. Technology therefore encompasses apparatuses or mechanisms, skills or practices (techniques), and some modes of organization. Finally, LEWIS MUMFORD suggested that humanity's most important technology was language itself. The skills and practices of complex communication were the key tool that enabled human development to accelerate. Thus technology is, in one sense, stored information and knowledge brought to bear on immediate requirements.

See also:

industrialization strategies

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CHRISTOPHER MAY

technology imperative

The term 'technology imperative' refers to the dominant organizing principle (or principles) around which applications of knowledge and skills, organizational and mechanical, cohere and contribute to economic performance and the nature of economic exchange. When viewed in a historical context, such organizing principles change over time and differ across regions. Accordingly, fundamental shifts in the nature of the technology imperative over

time heralded (even defined) the major economic 'revolutions' and their implications for the social order.

The agricultural revolution ushered in a shift from hunting to agriculture as the principal source of food; the INDUSTRIAL REVOLUTION meant a shift from predominantly agrarian forms of economic activity to ones dominated by the physical manufacture of consumer and tradeable goods. The subsequent expansion in the scale and type of manufacturing activity throughout the nineteenth and twentieth centuries reflects commensurate adjustments to the prevailing technology imperative. And, at the beginning of the twenty-first century, we recognize that economic performance and the sources of competitiveness are increasingly contingent on knowledge-based activities. This does not mean that agriculture and industry no longer have any technological relevance, or that manufacturing is becoming obsolete. Rather, it points to the introduction of a new and increasingly dominant technology imperative, namely that characterized by high knowledge content coupled with high economic value.

Framed in the context of the production function, the technology imperative can be located as part of the element of 'TECHNOLOGY', which is commonly regarded as exogenous to overall output. The technology imperative, then, refers to the organizing principle that drives the manifestation and application of knowledge and skills for that factor. In practice, however, technology is seldom, if ever, exogenous. Moreover, entire disciplines of research and education are devoted to generating 'new' technologies and attendant practices.

The emergence of knowledge-driven economies and their increasing importance in economic performance in the twenty-first century is taken today less as a hypothesis than as a guiding proposition. Knowledge management, knowledge networking and knowledge generation – greatly enabled by the creation of cyberspace and virtual realities – reinforce the power of this proposition. The emergence of e-commerce in knowledge – as an extension of e-commerce in goods and services – illustrates

further the ways in which shifts in the technology imperative are reflected in the global economy.

NAZLI CHOUCRI

technology transfer

Technology transfer is a process through which knowledge flows across institutional and organizational boundaries. During this process, technology generated or applied in one place may be utilized elsewhere, and the purpose for which technology is applied may be other than the one for which it was originally intended. This process diffuses science and technology throughout human activity. At the same time, the diffusion of technology is always accompanied by cultural and behavioural change, adjustment and assimilation into a socioeconomic environment.

Technology transfer can be divided into three types, according to the boundary knowledge is flowing across: 'vertical transfer', 'horizontal transfer' and 'hybrid transfer'. Vertical transfer is knowledge flowing from science to technology and to the practical world, or the process of getting the knowledge out of the laboratory and literature and into the hands of the users. It reflects the developmental process of technology. Horizontal transfer is knowledge flowing across geographic boundaries, particularly national ones. It means the utilization of technology for the same purpose in different regions. Hybrid transfer is the combination of the other two types of transfer and has become a popular concept in the context of GLOBALIZATION. In the fields of INTERNATIONAL POLITICAL ECONOMY (IPE) and international business, it is horizontal transfer and hybrid transfer that draw most attention from scholars and practitioners.

Technology transfer is a complex process, involving various interactive elements. The studies on technology transfer have been acquired through dealing with each of these five elements or a combination of them:

'transferer', 'transferee', 'TECHNOLOGY', 'transfer channel' and 'transfer barriers/stimuli'.

The transferer is one of two ends in the transfer process. It can be a technology-holder or a middleman of technology. The behaviour of a transferer is regarded as more important than that of a transferee, since the demand for technology is assumed to have no constraints. Willingness and capability to send are two basic features of a transferer. When a transferer's technology capability is higher than a transferee's and the transferer's need totally or partially coincides with that of the transferee, technology transfer will take place.

The transferee is the other end of the process. It can be a private enterprise, a state-owned firm or certain personnel. Two qualities possessed by a transferee are crucial for technology transfer. First, it must be willing to obtain inward technology, no matter what the motive is behind it. Second, it should have some capability to absorb contacted technology. Scholars have suggested that the most distinctive factor determining the success of technology transfer is the early emergence of an indigenous technological capacity.

Technology is the subject of technology transfer. It varies in different projects, but only exists in three forms: 'soft-form', 'hard-form' and 'medium-form knowledge'. Soft-form knowledge refers to people's skills and experiences acquired in fulfilling various tasks, such as operating a computer. It is still accommodated by the human body and is entirely intangible. It can only be transferred through people's movement and contact. Hard-form knowledge refers to different human-made materials and equipment, such as computer hardware. It is an embedded human creation and is entirely tangible. It can be moved and used independently. Medium-form knowledge lies between these two and is mainly in the form of design or written documents, such as computer software or manuals. Differing from soft-form knowledge, it is no longer embedded in the human body and can be separately transferred; differing from hard-form knowledge, it shows strong interactive capability and

cannot work independently. The particular combination of the three forms of knowledge is subject to the usage of technology in any given environment and shows different levels.

The transfer channel refers to the ways in which the transferer and the transferee are connected. It can affect either the volume of technology flow within it or the learning mechanism employed by the transferee. There are three types of channels: 'commercial-operation', 'knowledge-dissemination' and 'people-movement related'. Channels that are commercial-operation related include selling, JOINT VENTURES, wholly owned investment, LICENSING, franchise, TURNKEY PROJECTS AND INDUSTRIES, and so on. In these channels, technology is comparatively accountable and technology transfer is under formal agreement. Channels that are knowledge-dissemination related include open literature, technological assistance, exchange programmes, seminars and technological promotion campaigns. In these channels, knowledge flows usually do not proportionately relate to the likely payments. Channels that are personal-movement related include immigration/emigration, visits and other forms of personal contact. They are characterized by the lesser accountability of the technology flow and the absence of specific payment.

Transfer barriers/stimuli result from the existence of boundaries between science and technology, stages of technology development, and enterprises and nations. There are two aspects to how these boundaries accelerate or hinder technology transfer. One is technique-oriented, resulting from whether the transferer can pack technology in a deliverable way and whether the transferee can unpack the technology in an assimilative way. The second aspect is non-technique-oriented. Under this category, the priority considerations are always price, control of technology and the social impact of technology transfer.

Globalization makes technology transfer (particularly international technology transfer) a key consideration for MNCs and NATION-STATES. Transferers are concerned more about the sharing of innovation costs and tend to

Teheran and Tripoli Agreements

include technology transfer as part of their GLOBAL STRATEGY; transferees are concerned with short-cutting their learning curves through technology transfer; host countries aim to maximize inward flows of technology by using their technology policies for leverage (see TECHNOLOGICAL POLICY).

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PING LAN

Teheran and Tripoli Agreements

The Teheran and Tripoli Agreements of 1971 demonstrated the growing power of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) as, for the first time, oil companies agreed to negotiate collectively with their host-governments to fix the price of crude oil. Two separate meetings were held, one for the Persian Gulf producers (in Tehran) and another for the Mediterranean exporters (in Tripoli). Both agreements incorporated a substantial rise in posted prices and provision for further annual increases for the following five

years. However, hopes that the two agreements would bring stability to the oil industry were undermined by rising INFLATION and the devaluation of the US dollar.

FIONA VENN

telecommunications

'Telecommunications', defined as all forms of messages transmitted electronically using either radio- or wire-based technologies, represents a key infrastructure in the international political economy (IPE). Historically, the invention of telegraphy in the 1830s facilitated the spread of industrial CAPITALISM and colonial empires. This was followed by a growth of radio and telephony in the early twentieth century that elicited keen competition among governments and private companies for control of the new technologies.

Given the key role of telecommunications in achieving and maintaining political and economic POWER, international regulation of telecommunications has long been a subject of dispute. Industrial policies to rapidly develop national and overseas links were often pursued at the expense of international cooperation and telecommunications were a prime target for enemy forces during wartime. Until after World War II, these tensions were largely focused among European countries and the United States, as the leading industrial powers. By the early 1960s, however, dissatisfaction among countries with inequitable access to the natural resources (that is, radiofrequency spectrum, geostationary orbit) enabling telecommunications began to be expressed. Developing countries also objected to the legacy of colonial rule making it difficult to communicate with geographical neighbours without routing through the 'hubs' of European capitals. This discontent led to demands within the INTERNATIONAL TELECOMMUNICATION UNION (ITU) for a New World Information and Communication Order during the 1970s.

The debates in the ITU for a reallocation of telecommunication resources coincided with

upheavals in the IPE that spurred many governments to information-based industrial policies. The competition to create a so-called 'post-industrial society' led to DEREGULATION and PRIVATIZATION of the telecommunications sector, heavy investment in RESEARCH AND DEVELOPMENT (R&D) and rapid technological innovation. This restructuring was central to the GLOBALIZATION of financial markets. By the late 1990s, ownership of telecommunications worldwide was dominated by a small number of private companies located within a few countries. The planned convergence of technologies into an integrated services digital network (ISDN) is expected to underpin the continued process of globalization.

See also:

information society/economy; Japanese telecommunications technology industry

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KELLEY LEE

teletype

The 'teletype' was a machine introduced in the 1930s by the Teletype Corporation that com-

bined the technology of the typewriter (as an input and printing device) with the telegraph. By extension, the term can be used for any computer terminal. It is sometimes used to refer to the particular terminal controlling a given job, and is also a Unix command that outputs the name of the terminal controlling a given job. Thus, by further extension, a teletype is also any serial port on a Unix machine, whether or not the device connected to it is a terminal.

ROBERT M. CUTLER

telex

Telex is a telegraph service that was introduced in Europe in the early 1930s, enabling subscribers to transmit and receive messages. Telex communication is widely recognized as a legal method of conducting business transactions; it is secure because it confirms both the sender and recipient, before and throughout the transmission.

See also:

teletype

J. ANDREW GRANT

terms of trade

The concept of 'terms of trade' is central to important issues in economics and political economy, and has featured in major controversies. The concept in its most commonly used and simplest form denotes a ratio of two prices or a relative price. Typically, it is used for ratios of price averages representing important bundles of commodities. In international economics, it refers to the price ratio of exports to imports. Particular attention has focused on the terms of trade of developing countries and, in relation to that, the terms of trade between primary products and manufactures, since developing countries' exports are more heavily

terms of trade

weighted towards primary commodities than are their imports from the developed countries. Terms of trade are relevant to most areas of economics, both micro- and macro-, but especially to economic development and to issues of welfare and income distribution.

Until the 1950s, the dominant view was that primary goods prices would rise relative to manufactures as limited land and resources would lead to primary-product scarcity and hence to rising relative prices in the face of increasing population. These supply-side constraints have been attenuated by productivity growth and discoveries of new deposits, but may reassert themselves. In contrast, the PREBISCH-SINGER HYPOTHESIS states that there is a long-run tendency for the terms of trade of developing countries' primary products to deteriorate *vis-à-vis* the developed countries' manufactures. Despite a surge of oil prices in 1999 it is a fact that, in the last years of the twentieth century, indexes measuring these terms of trade showed a more adverse situation for developing countries on this front than at any significant time interval in the last hundred years or more. It has nevertheless been hotly debated whether there is an underlying trend, with reservations expressed about statistical methodology and the quality and meaning of long-range index numbers. But with the bout of very severe deterioration observed in the 1980s and not reversed since, the sound of these reservations has been muffled, if not silenced. The Prebisch-Singer hypothesis, when enunciated in the mid-twentieth century, carried a weighty message not as an observation about the past but as a prediction about the future. Many of the considerations were adduced in support of the hypothesis at that time – on the demand side: low income elasticity for primary products, diminishing raw material content of final output, replacement of natural materials with synthetic substitutes; on the supply side: abundant cheap labour in developing countries. These still apply and may continue to dominate, although a successful policy of diversification prompted by the Prebisch-Singer hypothesis may itself contribute to making the hypothesis ultimately

less applicable. However, it should be noted that these falling terms of trade could, in principle, be due to relatively low productivity-growth in developing countries' food production (Lewis, 1969).

From a micro-economic standpoint, a long-term deterioration of the terms of trade (fall of export prices relative to imports) would be an incentive for a shift of resources away from the production of traditional exportable goods. In the development context, the prediction of a continuing deterioration of the terms of trade of primary products relative to manufactures was one of the major pillars on which rested the case for a policy-engineered acceleration of the shift towards manufacturing in developing countries.

At the macro-economic level, a striking instance of terms of trade effects occurred following the sharp oil price rises of the 1970s. The resulting deterioration in the terms of trade of the industrial countries and the consequent decline in real incomes in these countries led to a fall in demand for goods and services which was not offset by a matching expansion of demand by the gaining countries (the oil exporters). The net fall in aggregate world demand generated by the terms of trade was a major source of the depression of the late 1970s.

The welfare and income-distribution effects of the terms of trade attract the most attention. Policy implications in this area are inevitably highly contentious because they involve winners and losers. Any group of people who, by virtue of a terms-of-trade deterioration, can buy less this year with each unit of their produce than they could the year before are worse off, other things being equal; they have suffered an adverse redistribution of real income. The striking and unambiguously adverse welfare and redistributive effects of a deterioration in the terms of trade depends on the assumption of other things being equal. This assumption will be appropriate if the deterioration is exogenous to the group under consideration – for example, a country of heavy coffee consumers faced by a sharp rise in price due to frosts in Brazil. But will it be appropriate if the deterioration is endogenous – for

example, a fall in the price of rubber resulting from the introduction of higher-yielding trees? The lower price will now be associated with a higher value of rubber exports. Welfare and redistributive effects for rubber-producing countries will be determined jointly by price and volume changes or, more correctly in this instance, by price and productivity changes (since it is the latter which underlie the volume change). Increasingly complicated terms-of-trade concepts have been devised to cope with such considerations. In 'double factorial terms of trade', the price ratio is multiplied by the ratio of productivities in the respective export sectors of the two parties in the transaction, to give the best indicator of redistributive effects so far; the 'employment-corrected factorial terms of trade' adjust also for differences in employment levels between the two parties.

When the expression 'terms of trade' is used, it usually refers to the simple price ratio. In the technical literature it is known as the 'net barter terms of trade'. It is by far the most widely used of the terms-of-trade concepts and, despite its limitations, is undoubtedly useful and has the additional appeal of simplicity.

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JOHN SPRAOS

territoriality

'Territoriality' is a common method for determining influence, using bounded spaces in the

exercise of power (Sack, 1986: 1-2, 5). Certainly territorial behaviour is exhibited by numerous animal species, leading some scientists to conclude that it is a biologically motivated and inherited trait. Nevertheless, social scientists in general and international relations (IR) theorists in particular, have avoided this evolutionary claim. They have preferred to treat territoriality as a strategy - a social construction unique in human history. IR scholars argue that the modern system of rule characterized by the territorial STATE was not inevitable: the means for organizing political life need not have become territorially fixed, functionally similar and mutually exclusive. As John Gerard Ruggie argues: 'The central attribute of modernity in international politics has been a peculiar and historically unique configuration of territorial space' (Ruggie, 1993: 144).

The modern state apparatus both delineates and defends national borders - by definition the state is a territorial body. But in the modern conception of the state, territoriality is also linked to SOVEREIGNTY and NATIONALISM. Sovereignty and TERRITORY provided the basis for the modern international system that emerged after 1494 and was finalized by the Treaty of Westphalia in 1648 (see WESTPHALIA, TREATIES OF). Sovereignty implies that there is one final and absolute authority in the political community. Within its territory, the state has sovereign power and interference in the internal affairs of a country is considered an offence against international law (Taylor, 1989: 139). Territoriality is also essential in forging and maintaining a cohesive social group - location within a territory defines membership of a group. Nationalism involves socialization and identification with specific territory, and the definition of others outside that territory. Thus, in the modern world, territoriality is not merely used to delimit and defend occupied land, but also as a means of self-definition (Sack, 1986: 27).

In focusing on the concept of territoriality, IR scholars have frequently positioned their arguments in opposition to STRUCTURAL REALISM or NEO-REALISM. For example, Ruggie

territoriality

(1986; 1993) argues that neo-realism fails to describe or explain the most important change in international politics: the shift from the medieval to the modern international system and the significance of this transformation. Medieval and modern systems of rule were both anarchic, but the difference between the two cannot simply be attributed to differences in the distribution of capabilities among the units (Ruggie, 1986: 141–2). In contrast to the modern means of structuring territorial space, the medieval system of rule made no distinction between internal and external political domains, separated by clear boundaries. Medieval politics was also characterized by non-exclusive forms of territoriality, in which authority was personalized and mobile: 'The relations of lord and subject were personal ones of protection and service and were not territorially based' (Taylor, 1989: 139). As Ruggie notes,

The notion of firm boundary lines between the major territorial formations did not take hold until the thirteenth century; prior to that date, there were only 'frontiers,' or large zones of transition.

(Ruggie, 1993: 150)

Neo-realism's sparse conception of international structure makes it 'impossible to define [this] structure of modernity in international politics' (ibid.: 152).

The transformation that generated this modern model of political organization – a system of territorial states – has been linked to both economics and security. Economic and military historians suggest that the state system prevailed because it comprised units of an efficient size to provide PROPERTY RIGHTS and security. As the gunpowder revolution in warfare made city ramparts obsolete, for instance, new offensive technologies required a firm territorial basis, not the medieval period's personal hierarchy of power and authority (Herz, 1957). Increased trade also drove the demand for larger polities that were better equipped for extracting resources from the public. Hendrik Spruyt (1994), for example, argues that the growth of trade and the

concomitant rise of towns generated new political forms that succeeded medieval rule – territorial states, city-states and city-leagues. The territorial state ultimately displaced these other institutional possibilities in Europe, because it was more efficient at fighting WAR and creating predictability in the domestic economy. Having a larger territorial organization coordinate the smaller ones ensured cooperation and efficiency among local units. The sovereign territorial state proved more effective at preventing defection by its members and the FREE RIDER PROBLEM, reducing internal transactions costs, and allowing rulers to make credible commitments to other political units. In time, actors from non-state arrangements either defected to states or copied the superior organizational type. Other scholars, however, insist that new conceptions of territoriality were less a result of RATIONAL CHOICE than a broader transformation in social understanding that reached beyond the domains of politics and economics – that is, the notion that people are organized by states which have authority over defined territories is best viewed as a historically conditioned idea, not a materially driven necessity (Cox, 1986: 218; Ruggie, 1993: 160–3).

Since world politics need not have been represented by territoriality, and because it is possible to trace the origins of this idea, some international political economists suggest that it is also possible to detect signs of its weakening. According to many IR scholars today, the territorial state is suffering from a form of crisis. SUSAN STRANGE, for example, has suggested that the internationalization of the WORLD ECONOMY challenges the traditional territorial state system: 'the progressive integration of the world economy, through international production, has shifted the balance of power away from states and toward world markets' (Strange, 1996: 46). According to Strange, increasingly integrated world markets have created a borderless, non-territorial space in the world economy that co-exists with national economies. TECHNOLOGICAL CHANGE and GLOBALIZATION place severe limits on state influence and authority over economic

transactions is exercised by actors other than states, such as MULTINATIONAL CORPORATIONS (MNCs). Multinational corporations have replaced the state in controlling a growing range of economic activities from control over industry, services, trade, RESEARCH AND DEVELOPMENT (R&D) to labour-management relations. Strange argued that the state has even retreated from traditional arenas of its authority, such as the defence of national territory. She argued that in many countries the need for the state to defend society against foreign aggression no longer exists and that, in any event, most territorial states do not enjoy a monopoly over the legitimate use of force. Strange also emphasized that territory has ceased to be a critical factor in determining national wealth or POWER. In international politics, competition for shares in the international political economy has replaced competition for territory.

By contrast, other scholars contend that territorial states are not facing their demise and that TRANSNATIONAL ACTORS will not easily replace them. Critics note that large corporations, despite greater geographical manoeuvrability compared to territorial states, do not possess formal power – the right to make laws. The property of TNCs is guaranteed by the property laws of the states in whose territories their property is located (Taylor, 1989: 168). Others argue that the territorial state system exhibits remarkable longevity because legitimate alternative ways of organizing political life were foreclosed long ago, and because substitute systems would require far-reaching social and economic changes. The breadth of the territorial state, in terms of its links with other social units, and the depth of the state, reflected in citizenship as a source of self-identity, makes it hard to dislodge. As Stephen D. Krasner points out:

sovereign states have become increasingly formidable institutions ... Change the nature of states, and virtually everything else in human society would also have to be changed. Hence, even though environmental incentives have dramatically changed since

the establishment of the state system in the seventeenth century, there is little reason to believe that it will be easy to replace sovereign states with some alternative structure for organizing human political life.

(Krasner, 1989: 79)

See also:

anarchy, international; billiard ball model; geopolitics; nation-state

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territory

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MIRIAM FENDIUS ELMAN

territory

‘Territory’ is a term used to describe a portion of terrestrial space occupied by a person, group, local economy or state. When associated with the STATE, the term has two specific connotations: (1) of territorial SOVEREIGNTY, whereby a state claims exclusive legitimate control over a given area defined by clear BOUNDARIES; (2) of an area not fully incorporated into a state, as with a colonial territory (British Antarctic Territory) or a frontier region (Northern Territory in Australia). More generally, ‘territory’ refers to the bounded social space occupied and used by different social groups as a consequence of following a strategy of TERRITORIALITY. Human territoriality is a strategy used by individual persons, groups and organizations to exercise POWER over a portion of space and its contents (Sack, 1986). This exercise of power can range from the bubble of personal space of an individual person to the spaces associated with membership of different groups, through patterns of territorial REGIONALISM (as, for example, in FEDERALISM) to the division of world-space into territorial NATION-STATES. Beyond its capacity for providing a space for individual action, territoriality is a relatively efficient way of maintaining centralized control at the same time as providing a service or activity to a localized population. In this way, space is partitioned into territorial cells or units that are grouped together in hierarchical sequence –

from the basic unit in which work, administration or some other activity is controlled or supervised, to intermediate levels at which managerial or supervisory functions are located, to the top-most level at which central control is exercised. Power is thus diffused and controlled at one and the same time by means of territory.

Historically, empires, states and churches were the most important agents of territorial organization. But today transnational and global businesses use territorial hierarchies that cross-cut existing political and religious ones (Agnew, 1994). Subsidiaries and branch plants, and the flows between them, are organized within such territorial frameworks. In the face of such developments, some commentators have been led to claim that a process of ‘deterritorialization’ is now under way. It is said that a world of flows between global networks is leading to the eclipse of territory as a principle of political-economic organization. From the point of view of states, this may well be the case. What it misses, however, is the degree to which the agents of globalization are organized territorially and base their operations on exploiting continuing territorial differences in tariffs, taxes and other political-economic conditions. Therefore, though varying historically and around the world in its agents and degree of formality, territory as a mechanism of political-economic control is always with us.

The sociological basis to territory involves both material designation and symbolic/emotional investment. Territories are established in three mutually reinforcing ways: (1) by popular acceptance of classifications of space through boundaries separating what is legitimately ‘ours’ from what is ‘yours’ or ‘theirs’; (2) communication of a sense of place or identity associated with the bounded space, and (3) enforcing control over the bounded space through policing, surveillance and guardianship. A mixture of consent and coercion, therefore, underpins territory. It is never simply coercive, but requires for its efficacy a degree of popular acceptance or legitimacy.

Sometimes the term ‘territory’ is used as an

equivalent to such spatial concepts as 'place' and 'region', conveying the sense of a clustering or concentration of people or activities. It also finds increasing use as a metaphor: for example, the 'territory' of the economist, with reference to the academic division of labour; the 'territory' of the imagination, symbolizing both an inner psychological 'terrain' and personal ownership of it. This latter metaphor betrays the modern origins of the term as associated with state sovereignty, in the definition of private property rights guaranteed by the state and the modern 'self' owning or investing exclusively in its territory.

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JOHN AGNEW

THIRD INDUSTRIAL REVOLUTION

see industrial revolution, third

Third World

The origins of the term 'Third World' remain contested, but appear to date to early post-war France where the term also carried an allusion to the Third Estate (the rising but under-represented CIVIL SOCIETY prior to the French Revolution). Subsequently, the term took on a variety of political, economic and even cultural connotations.

First, the Third World was distinguished from the FIRST WORLD of the advanced industrial states, or the 'West', and from the SECOND WORLD of the pre-1989 socialist bloc, or the 'East'. In this political meaning, the assertion of a distinctive Third World identity implied

distance from either of the two main geopolitical and ideological blocs of the COLD WAR period, centred on the United States and the Soviet Union respectively. The most significant political manifestation of this conception of Third World identity was the NON-ALIGNED MOVEMENT (NAM). This grouping of developing countries advanced common political principles, including non-alignment with either super-power, an end to the nuclear arms race and disarmament, DECOLONIZATION and a broader assertion of the right to self-determination and the norm of non-interference.

Second, the term was used to denote the underdeveloped, less-developed or developing countries, regardless of their political alignments. This conception of the Third World suggested the stratification of the world economy into rich and poor nations; in the 1980s, the term SOUTH became a virtual synonym, propelled to prominence by the influential BRANDT REPORT (1980).

However, the term was not simply descriptive of developing countries, it also suggested identification with a political critique of the organization of the international political economy and its institutions. Third World – and 'Third Worldist' – critics of the post-war political economy argued, first, that the trade and financial relations between the advanced industrial countries and developing countries were disadvantageous in various ways, increasing economic and political vulnerability, worsening poverty and imbalances in income distribution, reducing the opportunities for long-term growth, and increasing the gap between rich and poor countries. Second, it followed that developing countries should opt for various forms of individual or collective self-reliance, reducing their dependence on the North. Finally, INTERNATIONAL ORGANIZATIONS (IOs) needed reform to focus more squarely on problems of UNDERDEVELOPMENT, both through increased aid and the granting of preferences, and through more active interventions (such as controls on the behaviour of multinationals or the organization of commodity markets to reduce price volatility).

Third World

This critique of the world economy was carried politically by the GROUP OF 77 (G-77), formed during the first session of the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) in 1964 and active in the UNITED NATIONS (UN) and its affiliated organizations. The high-point of G-77 influence came in the 1970s, when the oil embargo seemed to signal a profound long-term shift in international economic power in the direction of developing countries and the G-77 advanced a program for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO). In fact, other commodities did not lend themselves to CARTELIZATION, most developing countries were harmed rather than helped by the oil shocks and the onset of the Latin American and African debt crises in the 1980s (see DEBT CRISIS) ushered in an entirely different set of economic problems. G-77 influence over the international economic policy agenda waned dramatically in the 1980s.

A final dimension of the concept of the Third World is cultural and somewhat more diffuse. Third World critics accused the West of cultural hegemony, IMPERIALISM and RACISM, and championed the legitimacy and value of national heritage and culture. Third World literature grappled with personal and social issues of cultural conflict, and cross-fertilization between Western and non-Western music gave rise to a rich and commercially successful 'world music' movement. These cultural claims resonated politically with some members of ethnic minority populations in the advanced industrial states. In both the United States and the United Kingdom, certain political groups argued for solidarity and even identification with the Third World and its culture.

In the 1980s and 1990s, both the political and economic meaningfulness of the concept began to fray. The developing countries became increasingly heterogeneous over time, ranging from the high-growth NEWLY INDUSTRIALIZED COUNTRIES (NICs) of East Asia to a number of low-income and slow-growing countries in SUB-SAHARAN AFRICA, South Asia and the western hemisphere. The term 'FOURTH WORLD' even gained currency, at-

tempting to capture the distinctiveness of the very poorest of the developing countries. As the Third World became more differentiated, its economic interests also diverged, making it more difficult to reach consensual positions in IOs. Moreover, many developing countries explicitly or implicitly rejected the economic arguments on which earlier Third World claims were based, choosing to integrate more closely with the world economy.

The events of 1989 undermined the political meaning of the term, as bipolar rivalry waned and the socialist bloc contracted. Nonetheless, there are strong residues of Third World identification and Third Worldist argument in anti-Western political movements and ideologies, including those emanating from the Muslim world. Although the analytic utility of the term has diminished, it is premature to say that the ideas associated with the Third World as a political movement have disappeared.

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STEPHAN HAGGARD

TIED AID see aid, tied

TIGER ECONOMIES *see* Four Tigers (Asian)

time–space compression

‘Time–space compression’ is a consequence of the process MARX termed the ‘annihilation of space by time’ through improvements in transport and communications technologies: the ultimate outcome is virtual reality, by which a person located in one place can simultaneously be in another. Changes in the costs and speeds of these technologies facilitate movement and the time–space convergence of places linked on the relevant networks. Time–space compression implies more radical alterations in the nature of the world, however, involving a shift in the experience of life as well as its technological facilitation. Bringing places together in electronic rather than physical space creates a hyperactive world, especially under CAPITALISM, in which all is flux and things are difficult to locate. But not everybody, everything and everywhere are equally implicated: some people and places are excluded because they live in electronic ghettos that are bypassed by the virtual flows; others devise new forms of regulation to ‘locate’ electronic messages and subject them to scrutiny and control.

See also:

laissez-faire; neo-colonialism

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RON JOHNSTON

Tinbergen, Jan (1903–94)

Jan Tinbergen was awarded the first Nobel Memorial Prize in Economics in 1969, together

with Ragnar Frisch. The Nobel Prize committee praised them for ‘having developed and applied dynamic models for the analysis of economic processes’. An appropriate addendum might be that Tinbergen always developed and applied models for the betterment of humanity.

Tinbergen was not trained as an economist. He studied physics at the University of Leiden from 1921 to 1926, where he was most influenced by his supervisor Paul Ehrenfest. His interest in economics was already noticeable in his 1929 Ph.D. thesis, which covered minimum problems in physics and economics.

Two elements stand out in Tinbergen’s approach to economics: quantitative and policy relevance. The quantitative character of his work was primarily developed before World War II, when he worked at the Central Bureau of Statistics (1927–45). He developed his academic qualities as Professor of Economics at the Netherlands School of Economics in Rotterdam (1933–73). Among his early achievements were spelling out the dynamics of business-cycle movements in farming and shipbuilding (the COBWEB THEOREM). His theoretical work served a higher purpose, however: the development of macro-economic models in order to understand the dynamics of national economies and provide solutions to social problems. The earliest formulation of such a model was a paper entitled ‘An economic policy for 1936’, read before the Dutch Economic Association (Klaassen, Koyck and Witteveen, 1959). In 1936, Tinbergen was invited by the League of Nations to extend his work on the Dutch economy and quantify and test various business-cycle theories described verbally by Haberler in *Prosperity and Depression* (1937). The results were published in 1939 in the two-volume *Statistical Testing of Business-Cycle Theories* – the first volume was extensively criticized by JOHN MAYNARD KEYNES.

Immediately after the war, Tinbergen was appointed Director of the Central Planning Bureau in The Hague (1945–55), which became a dominant institution in the reconstruction of the Dutch economy. Tinbergen’s post-war work

concentrated on the development of policy theory to systematize the haphazard way in which economic policy was formulated at the time. He showed, for instance, that the three policy objectives of full employment, price stability and BALANCE OF PAYMENTS equilibrium could not be achieved without the use of three specific instruments. His theory of economic policy soon became a standard tool in the economist's toolbox. From 1956 onwards, Tinbergen's interest shifted from economic policy analysis to the problems of DEVELOPING COUNTRIES and an optimum economic WORLD ORDER.

Considering the obstacles Tinbergen had to face during his career, one can only admire the power with which he transformed the discipline of economics.

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HENDRIK P. VAN DALEN

TIPA-Net

TIPA-Net, or Transferts Interbancaires de Paiements Automatisés, is an electronic payments consortium developed by the Co-operative Banks to settle transactions between Belgium, Canada, France, Germany, Italy and the United Kingdom. TIPA-Net and other payments systems like EUROGIRO and the INTER-BANK ON-LINE SYSTEM (IBOS) provide benefits to private and corporate customers through the rapid transfer of funds and transparent commission charges. Such payments systems further the integration of

national economies by reducing the barriers to cross-border trade posed by traditional methods of international remittance.

CAMERON G. THIES

tit-for-tat strategies

A tit-for-tat strategy plays the iterated PRISONERS' DILEMMA game by cooperating on the first move and then making the same choice as the other player had for the previous move. This strategy has been shown to be very robust in that it does well with a wide variety of other strategies, provided that there is a sufficiently large chance that the same players will meet again. The strategy can get started with a small cluster, spread in a population and then resist invasion from strategies that refuse to cooperate (Axelrod, 1984). A problem with the tit-for-tat strategy is that it is overly sensitive to misunderstanding or misimplementation. This can be effectively corrected by adding some generosity (occasionally cooperating after the other player defects) or contrition (cooperating after being punished for an unintended defection) (Wu and Axelrod, 1995). Strategies based on RECIPROCITY, such as tit-for-tat strategies, are widely used by nations, as well as bats, birds and monkeys (Axelrod and Dion, 1988). Ongoing research programmes in economics, political science, computer science, evolutionary biology and other disciplines seek to understand the long-term evolution of strategies in populations under various conditions of interaction, limited rationality and adaptation.

See also:

duopoly; game theory

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ROBERT AXELROD

tobacco industry

Tobacco is native to the western hemisphere and was first introduced to Europe in 1556. US tobacco companies dominated the industry from the nineteenth century onwards, reaching their apex in 1911 when the US company *Dukes American Tobacco* controlled a staggering 92 per cent of the world's tobacco business. Dukes was subsequently broken up by anti-trust legislation into four successor companies: Liggett and Morris, Lorillard, American Tobacco and R.J. Reynolds.

By 1964, public-health concerns about the effects of smoking resulted in the first US Surgeon General's Report linking smoking to cancer. On the back of this report in 1966, legislation was first introduced in the United States that required manufacturers to display health warnings on their products. Throughout the 1970s and 1980s, health concerns contributed to the levelling off of tobacco consumption in the developed world, but this has been more than offset by rapid increases in the developing countries – increasingly the focus of the tobacco industry.

Today, the tobacco industry is dominated by five leading transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)): Philip Morris, R.J. Reynolds (now R.J.R. Nabisco), British-American Tobacco (who bought out American Tobacco), the Imperial Group and the Rembrandt Group. Between them, these five corporations produce over 40 per cent of the world's cigarettes. Philip Morris produces the most popular cigarette in the world, *Marlboro*, which as a brand name is estimated to be worth \$30 billion, second only to *Coca-Cola*.

In the United States, the tobacco industry has been particularly affected by a number of

highly publicized successful law suits brought by the anti-smoking lobby. The litigation frenzy culminated in a record-breaking civil settlement in 1998, by which the leading US producers agreed to a \$300 billion compensation deal with forty-six US states.

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JASON P. ABBOTT

Tokyo Round

The Tokyo Round (1973-9) was the seventh multilateral trade negotiation held under the auspices of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT). The round included tariff reductions, the negotiation of six codes addressing non-tariff measures (NTMs), a sectoral code on civilian aircraft and the revision of articles in the GATT.

Tariff reductions amounted to an approximately 34 per cent weighted average reduction of industrialized country tariffs. The round continued the formula approach to tariff reduction that was initiated in the KENNEDY ROUND. The Tokyo Round used a 'Swiss' formula, whereby larger tariffs would be reduced by a greater percentage than smaller tariffs. Significantly less liberalization was achieved in agricultural trade compared to manufacturing products.

The round focused on the creation of rules for NTMs. Six codes were concluded on the following NTM categories: customs valuation, import licensing, technical standards, subsidies and countervailing duties, government procurement, and anti-dumping measures. Negotiators failed to conclude a code on safeguards, due to an impasse on whether safeguards could be applied selectively. The codes formalized existing dispute-settlement practices. The

Torquay Round

NTM codes were not universally applied: each code applied only to those parties who were signatories of that code. While not necessarily liberalizing trade or decreasing the use of NTMs, the codes increased the openness and orderliness of the application of NTMs.

The Tokyo Round also included a framework agreement revising basic GATT articles, most prominently by incorporating preferential treatment for developing countries into the legal principles of GATT and by the inclusion of an infant-industries justification for safeguard measures in developing countries (see *INFANT-INDUSTRY PROTECTION*). Developing countries were neither unambiguous winners or losers in the Tokyo Round. They won provisions for 'special and differential treatment' in several NTM codes. However, tariff concessions on products of special interest to *LESS-DEVELOPED COUNTRIES* (LDCs) produced mixed results.

JANE WINZER

Torquay Round

The Torquay Round was the third round of the *GENERAL AGREEMENT ON TARIFFS AND TRADE* (GATT) negotiations, taking place in 1950-1. Whereas the first *GENEVA ROUND* (1947) and the *Annecy Round* (1949) together arrived at over 58,000 agreements on *TARIFF* reductions (mainly on manufactured goods, although also on some agricultural products), the Torquay Round mainly admitted new members. Named after the English seaside resort where it was held, it is sometimes invoked to allude to the changes in multilateral negotiations since that time.

ROBERT M. CUTLER

totalitarianism

'Totalitarianism' is a form of social rule which seeks total domination of each single individual in each and every sphere of life – from

political and economic activity to inner belief system and private desires. Totalitarianism, as distinct from dictatorship, features rule from an omnipresent centre by sudden and disruptive decree, attacks upon and liquidation of other forms of citizen-identification as subversive or special interests, the overriding of the distinction between fact and fiction on a culture-wide level, and a pervasive propaganda system which appeals to the primordial hatreds and fantasies of economically destabilized and insecure masses.

The underlying conditions for totalitarianism to grow as a mass social movement are large-scale unemployment, decay of social bonds and infrastructure, increasing rootlessness of life conditions, and a corrosive loss of shared moral bearings or – in the striking conceptualization of Hannah Arendt (1955) – 'a negative solidarity of atomized masses'. Arendt's classical study focuses on 'the only two forms of totalitarianism we know' – Nazism and *STALINISM*. Arendt warns, however, that totalitarianism is 'an ever present danger' grounded in 'the endless process of capital and power accumulation' which erupts past former historical and social limits by its 'alliance with a classless mob' (*ibid.*: 157, 314-5). Her reference to 'capital' as well as 'power' accumulation, revealingly, has not since been pursued by scholars of Arendt's work or of the etiology of totalitarianism.

The primary conditions of totalitarianism emerged again in the last decade of the twentieth century, with worldwide marketization of social relations, steep growth of mass unemployment in industrial nations as well as *NEWLY INDUSTRIALIZED COUNTRIES* (NICs), and the dislocation and insecurity of increasingly rootless populations through economic restructuring and the liquidation of social-security infrastructures. These conditions for the emergence of a transnational totalitarianism have not been linked to the marketization policies effecting them. At the same time, more powerful and omnipresent technologies of civil terror, electronically universalizable command from the centre and mass propaganda systems were pervading everyday social and individual

life, and a single officially sanctioned ideology was occupying former critical spaces. Together they provide the instruments and ideological conditions required to bear a totalitarian culture across the formerly insulating borders of NATION-STATE and SUPERPOWER divisions.

Whether borne by national or international vehicles of rule, the distinguishing characteristic of any form of totalitarianism is its comprehensive and strategic manipulation of mass behaviour and thought by a single pervasive IDEOLOGY whose measure is the totality of its rule and penetration of individual, social and environmental life at every level – from genetic reproduction through economic organization to thought structure and primary motivations.

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JOHN McMURTRY

Toynbee, Arnold J(oseph) (1889–1975)

Arnold Toynbee contributed to the scholarly study of both history and international relations (IR), as well as to the public debates concerning post-war planning in his capacity as Director of Studies at Chatham House (1924–54) and Director of the Government's Press and Research Service during World War II.

Toynbee's name is perhaps associated first and foremost with his monumental work, *A Study of History*, which extends to twelve volumes; the eleventh volume is a historical atlas and gazetteer, and the twelfth (and perhaps most interesting) is entitled *Reconsiderations*, in which he sets out the methodology that guided his analysis. Toynbee's assumption, convincingly argued, is that one cannot understand properly the events that occur within a

single state without taking into account the wider society – the civilization – from which that state draws its social, political, religious and economic mores, and with which it interacts. Thus the states of the world could be classified according to which civilization they belonged to: Western Christendom, Orthodox Christian, Islamic Society, Hindu Society and Far Eastern Society. The mammoth story that surveys the rise of these civilizations is one of sophisticated intrigue that enmeshes what present scholars might term 'social forces' and 'GLOBALIZATION', in addition to intermittent power politics, IMPERIALISM and international cooperation, at numerous levels of analysis and at each facet of civilization.

Toynbee's attempt to construct a macro-history of the world, to explain events of the past (and indeed, on occasion to prophesy the future), his appreciation of the interaction between politics, economics, religion and culture (and on occasion technology and education), and his ability to examine the interplay between behavioural and structural levels of analysis places his work within the school of 'world historians' or 'historical sociologists', among the likes of Oswald Spengler and Michael Mann. And, although Toynbee was engaged in a massive exercise in taxonomy in classifying civilizations, he was not preoccupied with 'neatness' and spoke of the 'misconception of the unity of civilisation'. Toynbee was therefore not a determinist, in the sense that he did not prioritize in his methodology any single facet of human conduct. In the 'Annex of Reconsiderations', he asks the important question: 'Is there any master-activity in human affairs?', to which the six-page answer can be distilled to 'it depends' and 'one cannot isolate one from the other'. For this reason, Toynbee criticized MARX for emphasizing economic structures far too heavily. For instance, though Toynbee acknowledged in the first volume of *A Study of History* that 'Western Civilisation has cast the net of its economic system all over the World, and this economic unification on a Western basis has been followed by a political unification', he went on to qualify this on the

Trade Act

basis of cultural and religious differences. By the same token, Toynbee has been criticized for an over-emphasis on cultural and religious causation.

That Toynbee observed firsthand both occasions in which nationalism ripped the fabric of western civilization prompted him to become a campaigner for political unification during and immediately following World War II. Disillusioned with warring states, he asserted in *Civilisation on Trial* (1948) that:

while the state of which we happen to be citizens makes more concrete and imperious claims on our allegiance ... the civilisation of which we are members really counts for more in our lives.

(Toynbee, 1948)

His position at Chatham House enabled him to take his ideas to both British and American audiences: advocating the replacement of the states-system with a 'universal state' (or world government), which was necessary if civilizations were to survive.

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JARROD WIENER

Trade Act

The US Trade Act of 1974 was a sequel to 1962's TRADE EXPANSION ACT. It authorized the president to implement tariff cuts of up to 60 per cent of current rates in multilateral negotiations following the enlargement of the EUROPEAN COMMUNITY (EC). Since tariff rates had been reduced by about one-third in the negotiations following the 1962 act, this was a 40 per cent reduction of 1962 rates; regarded as a sequel to all former TRADE AGREEMENTS legislation, the possible reduc-

tions would be from 9 per cent of dutiable items (as against 55 per cent in 1934).

With tariffs already much reduced, injury to domestic interests could no longer be attributed to particular tariff cuts, but was now to be given when imports rose, whatever the cause. Internationally, the rule of non-discrimination was extended from equal access for exports to equal access to supplies. But non-discrimination was somewhat breached by adherence to the GENERALISED SYSTEM OF PREFERENCES (GSP) for certain imports from LESS-DEVELOPED COUNTRIES (LDCs), though limited to half of such imports into the United States.

FREDERICK V. MEYER

trade agreements

Any initiative involving the cooperation of two or more governments to facilitate or regulate trade between their economies can be considered a trade agreement, but the basic forms are bilateral, minilateral (or regional) and multilateral (or global).

Bilateral agreements, which involve joint action between two countries, range from simple barter transactions to elaborate negotiations over policies and procedures of one country that affect the trade of the other. Most are relatively narrow attempts to exploit common interests in particular sectors (exemplified by the United States-Canadian agreement to permit duty-free trade in automobile parts) or to resolve trade disputes (such as the VOLUNTARY RESTRAINT AGREEMENT (VRA) which limited the sales of Japanese automobiles in the United States).

Multilateral trade agreements are generally very broad in both geographic scope and product coverage, exemplified by the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), which has organized eight rounds of global bargaining between as many as 124 nations since 1947. Such agreements are designed to enhance global prosperity by increasing global trade and to build cooperation among nations by increasing INTERDEPENDENCE. GATT is

credited with facilitating a many-fold increase in international trade by engineering a dramatic decrease in trade barriers, accomplished through elaborate negotiation procedures in which each nation offers reductions in **TARIFFS** in response to the reciprocal offers of other nations. The multilateral approach overcomes resistance to trade **LIBERALIZATION** because it does not require any nation to risk damage to its import-competing industries by eliminating protection against foreign competition without assurances that prospects for its export industries will improve enough to compensate.

The latest of the **GATT** negotiations, the **URUGUAY ROUND** (begun in 1986 and concluded in 1994), created the **WORLD TRADE ORGANIZATION (WTO)** to handle the complexities of trade management and dispute settlement, as well as to arrange future negotiations. It also extended trade liberalization to new sectors of the global economy and created global guidelines concerning **INTELLECTUAL PROPERTY RIGHTS (IPRs)**, investment rules and other coordination issues arising out of the open trade and investment regimes of the modern era.

In between bilateral and multilateral agreements are minilateral ones, most of which are regional arrangements among contiguous countries. The **NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)** is the leading example of such a trade agreement, now that the **EUROPEAN UNION (EU)**, which once held this designation, has advanced beyond the status of a trade agreement to become a charter for more extensive political and economic merger.

Minilateral agreements are distinguished by a two-tier structure of trade barriers, with each member-nation discriminating in favour of imports from other members by charging a lower tariff rate to their products than to those of non-member-nations. The effect of such discrimination, as originally analysed by Jacob Viner (1950) in his theory of **CUSTOMS UNIONS (CUs)**, is two-fold. When the lowered internal barriers result in trade creation within the region (displacing local production), the resulting welfare gains are positive-sum. When the discriminatory barriers result in trade diversion

– that is, when imports from outside the region are displaced by intra-regional trade – the benefits to members come at the expense of economies elsewhere, thus creating the potential for political conflict (see **TRADE CREATION AND TRADE DIVERSION**). However, regional agreements are easier to negotiate than global ones, in part because they offer various side-benefits to the participating nations.

Other regional agreements include the **ANDEAN COMMON MARKET**, **ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN)**, **CARIBBEAN COMMUNITY (CARICOM)**, **CENTRAL AMERICAN COMMON MARKET (CACM)**, **Central European Free Trade Agreement**, **COUNCIL FOR MUTUAL ECONOMIC ASSISTANCE (CMEA)**, **EAST AFRICAN COMMUNITY (EAC)**, **ECONOMIC COMMUNITY OF WEST AFRICAN STATES (ECOWAS)**, **LATIN AMERICAN FREE TRADE ASSOCIATION (LAFTA)** and **MERCO-SUR**. Most were inspired and modelled on the various forerunners of the **EUROPEAN UNION (EU)**, especially the **EUROPEAN ECONOMIC COMMUNITY (EEC)**.

See also:

governance, global

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BRUCE E. MOON

trade agreements legislation, US

The United States-led move towards freer trade started in 1934, when Congress authorized the president to implement internationally negotiated tariff cuts, though this was limited to a number of years and to half the current rates. When renewed, cuts of 50 or 60 per cent of

trade and aid provision

current rates were allowed where major negotiations were expected, less for other renewals. Tariff reductions were made in stages over several years. When fully implemented, the authority was renewed until 1967; since then, only for specified multilateral or regional negotiations.

Pre-war agreements were negotiated by the United States with one country at a time. Post-war agreements were simultaneously (multilaterally) negotiated between a number of countries. Although the number of participating countries increased substantially in the course of time, the freeing of trade remained largely a dialogue between the United States and European industrial countries. In the 1940s and 1950s, the United States cut tariff rates in return for other countries' adherence to the rule of non-discrimination. When US aid was given to European countries for reconstruction, this was to lead to the freeing of intra-European trade from quantitative controls, provided that this was generalized by the end of the 1950s. When this was achieved, six European countries formed a CUSTOMS UNION (CU), to which the United States responded with the TRADE EXPANSION ACT (1962). Since the subsequent KENNEDY ROUND of tariff negotiations led to tariff cuts and so deprived the EUROPEAN COMMUNITY (EC) of revenue, the latter had to deepen or become larger. Enlargement of the EC followed in 1973, to which the US response was the TRADE ACT (1974). This led to the TOKYO ROUND, which was followed by the formation of the Single Market in Europe and further enlargement. Then came the OMNIBUS TRADE ACT in the United States and the URUGUAY ROUND.

At the end of the twentieth century, US tariffs were among the lowest of the industrial countries. New initiatives were needed. One was the signing of the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) with Canada and Mexico; another was the extension of negotiations to include countries' domestic rules on service trades.

FREDERICK V. MEYER

trade and aid provision

Trade and aid provision consists of arrangements between an advanced country (or group of countries) and groups of LESS-DEVELOPED COUNTRIES (LDCs). The LOMÉ CONVENTIONS on aid and trade, for example, define the relationship to the EUROPEAN COMMUNITY (EC) of the group of sixty-six AFRICAN, CARIBBEAN AND PACIFIC GROUP (ACP) countries that were once European colonies.

This convention's trade provisions provide exemptions from tariff and other barriers designed to protect EUROPEAN UNION (EU) markets from cheaper imports. The aim is to promote and diversify ACP exports to the EU, thus stimulating growth and development in the exporting countries. These preferences are non-reciprocal, which means that ACP countries do not have to offer special access to their markets for EU products.

The convention's aid provisions are supported by European Development Fund (EDF) and by the EUROPEAN INVESTMENT BANK (EIB). EDF resources have been particularly important to sectors such as agriculture, education, health, rural development and transport.

ROBERT LOONEY

trade blocs

Definition and examples

A 'trade bloc' can be defined as a preferential trade agreement (PTA) between a subset of countries, designed to significantly reduce or remove trade barriers between member-countries. When a trade bloc comprises neighbouring or geographically close countries, it is referred to as a regional trade (or integration) agreement. It is sometimes also referred to as a 'natural' trade bloc to underline the fact that the preferential trade is between countries that presumably have low transport costs or trade intensively with one another. The two principal characteristics of a trade bloc are that (1) it

implies a reduction or elimination of barriers to trade, and (2) this trade LIBERALIZATION is discriminatory (in the sense that it applies only to the member-countries of the trade bloc, with outside countries being discriminated against in their trade relations with trade-bloc members). Though there are only a few, regional integration agreements also exist in which cooperation rather than preferential market access is emphasized. Trade blocs can also entail deeper forms of integration: for instance, integration of international competition, investment, labour/capital markets (including movements of factors of production), monetary policy and so on.

The integration of countries into trade blocs is commonly referred to as 'REGIONALISM', irrespective of whether the trade bloc has a geographical basis or not. The first waves of PTAs appeared in the 1930s, leading to a fragmentation of the world into trade blocs. This 'old' ('first') regionalism is also associated with regional initiatives involving developing countries in the 1950s and 1960s (Bhagwati and Panagariya, 1996a). Based on the objective of IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI), the rationale was that developing countries could reap the benefit from economies of scale by opening up their trade preferentially among themselves, hence reducing the cost of their individual import-substitution strategy while the trade bloc became more self-sufficient. More successful experiences followed with the recent proliferation of trade blocs, the so-called 'new' ('second') regionalism, which mostly involves countries from the North with the South (the North-South trade blocs).

The main trade blocs in the world are:

- 1 in Europe, the EUROPEAN UNION (EU), the EUROPEAN FREE TRADE ASSOCIATION (EFTA), the Europe Agreements and the EUROPEAN ECONOMIC AREA (EEA);
- 2 with the United States, the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), the Canada-United States Free Trade Agreement (CUSTA) and the United States-Israel Free Trade Agreement;
- 3 in Latin America, the Common Market of the South (MERCOSUR), the CENTRAL AMERICAN COMMON MARKET (CACM), the ANDEAN COMMON MARKET, the LATIN AMERICAN INTEGRATION ASSOCIATION (ALADI) and the CARIBBEAN COMMUNITY (CARICOM)
- 4 in sub-Saharan Africa, Communauté Economique de l'Afrique Occidentale (CEAO)/ Union Economique et Monétaire de l'Afrique Occidentale (UEMAO), Union Douanière et Economique d'Afrique Centrale (UDEAC), the Common Market of Eastern and Southern Africa (COMESA)/Preferential Trade Area for Eastern and Southern African States (PTA) and the Southern African Customs Union (SACU);
- 5 in Asia, the ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN) and the ASEAN FREE TRADE AREA (AFTA), and the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).

While there is a proliferation of PTAs in the world and while almost every country in Europe, in Latin America and in sub-Saharan Africa belongs to at least one PTA, not all PTAs are effective at liberalizing intra-bloc trade. For instance, focusing on the trend in intra-bloc trade intensities and shares, it appears that NAFTA, the US-Israel FTA, CACM, the Andean Group, Mercosur, CEAO/UEMAO and SACU can be considered effective trade blocs (which does not mean that they are efficient), whereas ASEAN seems so far to be a rather ineffective grouping (Foroutan, 1998).

The causes of trade bloc formation

Several reasons explain the recent emergence of trade blocs. Old regionalism was motivated by the desire of developing countries to pursue import-substitution development at a regional level, to insulate a region from the world economy, and to stabilize and foster the economy at a regional level. Political and economic considerations also played a major role, as in the case of the EUROPEAN COAL AND

trade blocs

STEEL COMMUNITY (ECSC) (1951) and the EUROPEAN ECONOMIC COMMUNITY (EEC) (1957).

The recent emergence of trade blocs (the new regionalism) has been explained by various factors (Baldwin, 1997). Recognizing the gains from liberalization, it is often argued that concluding a PTA is politically easier than pursuing multilateral trade liberalization agreements. It is easier to negotiate with few partners than with a large number of participants in a multilateral process under the terms of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)/WORLD TRADE ORGANIZATION (WTO). Not only can concessions be more easily exchanged between a small number of countries, but effective enforcement mechanisms can also be agreed at a lower cost. The length of the negotiations and the difficulties encountered during the URUGUAY ROUND of GATT (1986–94) are generally considered to have contributed to the increase in attractiveness of the regional (that is, preferential) path to trade liberalization.

PTAs also allow trading partners to go deeper and faster in their liberalization process, addressing modern trade barriers that are more varied, more complex and less transparent than the standard TARIFFS and QUOTAS traditionally considered in the GATT Rounds. Preferential integration agreements can also entail elements beyond standard trade policy concerns, such as competition, investment, and labour- and capital-market considerations. In other words, the fewer the number of participants to trade negotiations, the larger the number of issues on which it is possible to reach an agreement.

Another claimed advantage of PTAs is that they may help ensure the credibility of the reform process undertaken by one or several members of the trade bloc. Indeed, trade blocs often involve (small) reform-minded countries willing to bind their commitments to (often unilateral) liberalization processes by entering a PTA with larger entities. More generally, PTAs can serve as commitment, signalling and insurance mechanisms in the policy determination of its members, thereby contributing to reducing uncertainty and increasing the cred-

ibility of political and economic developments (Fernandez and Portes, 1998).

Trade blocs may exert other types of 'pressures for inclusion'. The gravity model suggests that countries geographically close to one another trade more than distant countries. Namely, the gravity equation predicts (among other things) that the volume of trade between two countries is negatively related to the economic distance (that is, geographic distance, taking into account transport costs and trade barriers) between them. As neighbouring countries tend to be 'natural trading partners', they are more likely to form a trade bloc. Moreover, as trade-bloc formation diverts trade at the expense of non-member countries, the deepening of an existing bloc or the creation of a new one may cause excluded trading partners to join the PTA in order to reduce the costs of being 'left out': the so-called 'domino effect' of regionalism (Baldwin, 1995).

Finally, trade blocs may serve to pursue non-economic objectives, or objectives beyond the immediate economic concerns of a PTA, such as political stability, democratic development or security issues (either domestic security or as a response to third-country security threats or security threats between partner countries) (Schiff and Winters, 1997).

The effects of trade blocs

Discriminatory trade policy is the defining characteristic of a trade bloc. The different types of trade blocs (or PTAs) can be broadly distinguished in three categories:

- 1 free trade agreements, where trade barriers among member countries are removed, but where each member remains responsible for the determination of its trade policy *vis-à-vis* non-member countries;
- 2 CUSTOMS UNIONS (CUs), with liberalized intra-bloc trade, as well as the adoption of a external tariff structure and trade barriers towards outsiders common to all members of the CU;
- 3 COMMON MARKETS, which entail a CU with deeper integration between its members

(such as free movement of goods, services and factors of production, common economic policies, and so on).

Most of the analyses on the effects of trade blocs focus on FTAs and/or CUs. The effects of a PTA are of two types: trade effects and welfare effects. The trade effects comprise the impact of a PTA on the volume and quantity of trade, on the terms of trade (that is, prices) and on the level of protection (generally tariffs) for PTA members and excluded countries. In analysing the welfare effects of a PTA, it is important to distinguish between the impact of trade bloc (formation and expansion) on the welfare of (1) each of its members, (2) the trade bloc as a whole and (3) the countries excluded from the trade bloc.

A standard result of international trade theory is that, in a competitive environment and in the absence of market distortions and EXTERNALITIES, free trade will maximize global welfare. Removing trade barriers between a subset of countries might therefore appear to be, *a priori*, a move in the right direction. Yet the theory of second best (see SECOND BEST, THEORY OF) points out that removing a distortion while others remain in place may not increase welfare (Lipsey and Lancaster, 1956). Trade blocs are examples of second best, since while one distortion is removed (that is, trade barriers between member countries) another distortion is created in the form of discrimination between members and non-members (the latter facing trade barriers from the PTA), as well as other market imperfections. Hence, the welfare implications of a trade bloc are ambiguous, depending on many factors.

The demonstration of the second-best situation entailed by a PTA was derived from the seminal work of JACOB VINER (1950), which shows that while liberalizing trade between a group of countries can lead to trade creation between members (which should increase welfare), it can also reduce trade between the CU and its trading partners. This trade diversion can potentially reduce welfare for all, as a member switches from a relatively efficient,

low-cost producer outside the CU to less efficient, higher-cost producer within the CU, leading to a global misallocation of resources (Meade, 1955; Lipsey, 1957; see TRADE CREATION AND TRADE DIVERSION). Most of the debate on the static impacts of trade blocs on the global economy rests on the theoretical and empirical evaluations of whether a PTA is more trade-creating or trade-diverting. Taking into account the gravity model, according to which trade between countries depends on their size and on transaction costs (including distance), Soloaga and Winters (1999) found no empirical evidence of significant trade creation during the 1990s for major trade blocs and a clear indication of trade diversion only in the case of the EU and EFTA.

Another important element in assessing the trade impact of a PTA are the price (or terms of trade) effects of a trade bloc. Again, as intra-bloc trade is liberalized while extra-bloc trade is not, PTA members buy more from each other (trade creation) and less from third countries. If the PTA is not economically small, world prices will be affected as the demand for (and thus the price of) non-member exports decreases, creating a positive terms-of-trade effect for PTA members and a probable deterioration of the terms of trade for third countries (Mundell, 1964). Hence, trade blocs allow member countries to exploit their joint MARKET POWER over their terms of trade.

This capacity to influence its terms of trade is an important element in the analysis of the trade-policy determination and welfare effects of a PTA. Due to their increased market power, the members of a trade bloc can extract rents from the excluded trading partners by setting 'OPTIMAL TARIFFS' and behaving in a coordinated strategic way.

Such considerations also lead to some predictions with regards the dynamics of trade blocs. In particular, it is expected that, if countries are symmetric, trade diversion and optimal tariffs increase as the world integrates into a smaller number of expanding trading blocs (Krugman, 1991a). Although the level of optimal tariffs with expanding trade blocs depends on the factor endowments (that is,

comparative advantages) of the member countries (Bond and Syropoulos, 1996), the welfare losses associated with trade-bloc formation and expansion seem to be due more to trade diversion than to potential increases in optimal tariffs (Krugman, 1993). Ultimately, the optimal number of trade blocs in the world depends on one hand on the potential positive welfare effects resulting from trade creation, and on the other hand on the potential negative welfare impacts resulting from trade diversion and adverse changes in the terms of trade.

Besides, a larger market resulting from the creation and extension of trade blocs does not only increase the market power of its members, but it also provides opportunities for greater productivity efficiency for industries facing ECONOMIES OF SCALE and increased competition within the PTA market. This in turn may contribute to reduce distortions within the trade bloc. In this respect, it is worth noting that small countries could benefit more from joining a PTA than larger countries, in particular if the trade bloc is initially formed by large members, as small countries will derive relatively larger economic advantages from gaining access to the potentially large market of the bloc.

Since trade blocs are more likely to have a positive impact on welfare if they are more trade-creating and less trade-diverting, it is sometimes argued that welfare-improving PTAs are likely to be those that (1) are large (stimulating intra-bloc trade), (2) involve countries at similar stages of development (generating intra-industry trade) and (3) have a regional basis (since geographic proximity favours trade). However, the main lesson from the new theory of regionalism is that there are no strict rules and generalizations are dangerous, as the impact on trade and welfare of PTAs crucially depends on the model adopted. For instance, although the notion of 'natural trade blocs' (based on lower transport costs associated to regional trade) is common (Krugman, 1991b; Frankel, Stein and Wei, 1995), it is doubtful that transport-cost considerations provide a justification (over other types of

cost) for the desirability or superiority of *regional* trade blocs over *non-regional* blocs. The fact that countries geographically close to each other trade more together, as suggested by the gravity model, does not imply that their welfare will improve by forming a trade bloc, nor that trade barriers against distant trading partners are desirable (Panagariya, 1998).

Finally, while most analyses on trade blocs either consider PTAs in general or associate trade blocs with CUs, the distinction between the forms taken by the PTA (namely whether it is a FTA or a CU) is crucial to determine the trade and welfare impact of a grouping of countries. Focusing on the rules-of-origin requirements in a FTA, it is tempting to conclude that CUs are superior to FTAs, as the former generate less trade diversion (Krueger, 1997). However, when considering the strategic interaction between members and non-members and their potential market power, FTAs could be considered more desirable on welfare grounds than CUs.

Regionalism versus multilateralism

The ambiguity of the static impact of trade blocs led to the current debate on whether the new wave of regionalism poses a threat to the multilateral liberalization process (because of the discriminatory nature of PTAs) or, on the contrary, is compatible with and even complementary to further global trade liberalization (as a stepping stone towards free trade). (Panagariya, 1999, and Winters, 1999, provide surveys of the literature.) In other words, are PTAs 'stumbling blocks' or 'building blocks' towards a more liberal multilateral trade system? The answer rests on the analysis of the dynamic time-path effects of trade blocs, and not simply on the (static) immediate impact of a PTA.

The proponents of the regionalism path towards multilateral liberalization emphasize the benefits of trade creation over the problems associated with trade diversion. They argue that PTAs support the integration of groups of countries into the international economy as they highlight the benefits from freer trade. As

such, regionalism helps create a momentum for global trade liberalization initiated by intra-bloc liberalization. This internal dynamic of trade liberalization and, more generally, economic reforms is particularly important in developing countries, where regional commitments can facilitate the integration of these economies into an increasingly sophisticated multilateral trading system (Ethier, 1998).

Another school of thought expresses serious concerns about the compatibility of trade blocs with the pursuit of multilateral liberalization. First, because of their discriminatory nature, PTAs generate trade diversion, which not only negatively affects excluded countries, but could also antagonize them, rendering multinational negotiations more difficult. Moreover, if (intra-industry) trade liberalization generates 'sunk costs' (for instance, costs associated with the setting up of a distribution network) or 'hysteresis' in trade, the trade structure of a country joining a PTA can be altered in the long run. This can delay or prevent further adjustments of trade patterns in the case of global liberalization and consequently reduce the incentive of PTA members to pursue the multilateral path to trade liberalization. Besides, regionalism may divert the attention of countries away from the multilateral system, as the former becomes an alternative to the latter.

Recently, more insight has been gained on the dynamic effects of PTAs from the political economy approach, which emphasizes the role of lobbying by interest groups in the determination of trade policy. The 'endogenous trade bloc' theory suggests that the answer to whether trade blocs help or hamper multilateral efforts and trade liberalization rests on the institutional characteristics of a PTA and the incentives for specific interests to influence the policy process. The latter depend, in turn, on the gains and losses incurred by lobby groups and the ability to coordinate their efforts. For instance, if the main agents within a trade bloc obtain disproportionately large gains from preferential integration over multilateral liberalization, then regionalism will undermine the multilateral system (Levy, 1997). This is more likely to be the case when

a PTA is trade-diverting (Grossman and Helpman, 1995; Krishna, 1998). Moreover, excluded countries which experience a decrease in their exports because of the trade-diverting effect of a PTA can be tempted to resort to protectionism as the relative size of their (lobbying) import-competing sector increases, reducing the chances for multilateral liberalization (generally supported by the export sector).

On the other hand, an FTA can help provide compensations to the losers from the removal of trade barriers within the FTA by reducing or maintaining external protection selectively, hence diluting domestic protectionist pressures. In that sense, an FTA could be complementary to MULTILATERALISM (Cadot, Melo and Olarreaga, 1998).

Finally, trade blocs can contribute to the internalization of global externalities and foster the adoption of coordination mechanisms among countries that may facilitate the multilateral process towards global trade liberalization. Hence, trade blocs can also be regarded as an endogenous response to the multilateral system, with a view to complementing multilateral liberalization and addressing economic, political and institutional concerns beyond the scope of the multilateral trade system.

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SANOUSI BILAL

trade creation and trade diversion

'Trade creation' refers to the beneficial effects of a FREE TRADE AREA (FTA) or CUSTOMS UNION (CU), while 'trade diversion' refers to their detrimental effects. The first to identify

them and analyse their impact on welfare was JACOB VINER, who realized that a customs union affects its member-countries in at least two different ways. First, trade between the partners expands as a result of the elimination of TARIFFS on products they trade among themselves. Second, trade with third countries declines because the preferential tariff elimination induces a shift of trade away from third countries, in favour of sources of supply in partner countries.

More precisely, trade creation raises welfare because it leads to the replacement of higher-cost domestic products with lower-cost partner products. As a result, relatively inefficient domestic production contracts while domestic consumption expands. Trade diversion lowers welfare because the preferential tariff enables higher-cost partner products to replace lower-cost products from third countries. In partial equilibrium analysis, this trade-diverting effect is signified by the loss of tariff revenue on free imports from partner countries.

The overall impact on welfare of the preferential tariff reduction in a FTA or customs union will depend on the size of the trade-creating and trade-diverting effects. A country that starts from a position of AUTARKY will always benefit, as the trade-diverting effect is zero and the country therefore experiences only trade creation. More generally, in a partial equilibrium context and under constant costs, there is a net welfare gain if the volume of trade created, multiplied by the difference in costs between domestic and partner producers, is greater than the volume of trade diverted, multiplied by the difference in costs between partner and third-country producers.

Note, however, that trade diversion is welfare-reducing because it is assumed that partner-country producers are not as efficient as those in third countries. If partner countries are the most efficient producers of the traded products, trade diversion will be zero and the FTA or customs union will unambiguously raise welfare. Also, if the members of a customs union can influence their TERMS OF TRADE with third countries, the preferential tariff elimina-

tion will cause a third beneficial effect – an improvement in the terms of trade. This improvement is caused by the diversion of domestic demand from third-country products to partner-country products. In this case, trade diversion may indirectly lead to welfare gains through the improved terms of trade.

The quantitative measurement of trade diversion and trade creation in actual customs unions, such as that of the EUROPEAN COMMUNITY (EC), has proved to be surprisingly difficult. Although most studies have concluded that the EC, for example, has benefited from net trade creation, it has been hard to separate the trade-creating and trade-diverting effects from the effects of tariff reduction on non-partner products, the general growth in world trade, and the effects of trade in similar products (intra-industry trade) rather than different products (inter-industry trade).

See also:

trade, inter-industry and intra-industry

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PHEDON NICOLAIDES

Trade Expansion Act

The 1962 Trade Expansion Act followed earlier trade agreement legislation in the United States (see TRADE AGREEMENTS LEGISLATION, US) by authorizing the president to implement tariff cuts of up to half the current rates when agreed in international negotiations. Its immediate purpose was a negotiation to ensure that US interests would not be injured by the new European CUSTOMS UNION (CU). A novel feature was provision of ADJUSTMENT ASSISTANCE to domestic firms and workers that were

hurt by rising imports following reductions in tariffs.

FREDERICK V. MEYER

trade, inter-firm and intra-firm

Intra-firm trade (IFT) consists of economic transactions that are international in nature but in which all partners belong to the same multinational enterprise (MNE). Inter-firm trade, by contrast, involves economic transactions between unrelated parties and may also be termed 'arm's-length trade'. In countries such as the United Kingdom and the United States, where some 80 per cent of economic activity is undertaken by MNEs, IFT can represent as much as one third of total national exports.

IFT takes two main forms: vertical sales (or exchanges from the centre to subsidiaries overseas) and horizontal sales (or exchanges between subsidiaries located in different countries). For example, subsidiaries might exchange semi-finished components between themselves, while headquarters organizes their movement to the assembly stage.

These internal markets are largely unreported and orthodox trade analysis has nothing to say about them. It is extremely difficult, therefore, to understand the extent and nature of IFT and its impact on international trade patterns. As more countries enter the international economy and regulations on how business may be conducted are reduced through the agency of the WORLD TRADE ORGANIZATION (WTO) and the INTERNATIONAL MONETARY FUND (IMF), it is likely that IFT will continue to grow in importance – just as the role of MNEs in the global economy is set to increase. However, it remains the case that monitoring activities will continue to be problematic, because the ways in which trade flows are measured are themselves inadequate for some purposes.

One particular phenomenon that has been influential in increasing the importance of IFT has been the rapid emergence and growth of

business groups from Korea (*CHAEBOL*) and Japan (*keiretsu*). Owing to a variety of cultural and political factors, these groups – which dominate their domestic economies in terms of exports, turnover and value-added – typically consist of a constituent company in nearly all usefully complementary industrial sectors: for example, a group might control a bank, insurance company, and manufacturing, distribution and retail outlets. It can then undertake all stages of production itself and goods might end up in its own department stores nationally, while those from rivals are excluded. This arrangement makes it extremely difficult for foreign firms wishing to enter the market and overseas governments would wish to see such groups disbanded. Indeed, the Korean government has responded to these demands – particularly after the financial crisis of 1997 and subsequent IMF intervention – such that groups are being devolved to a small number of core companies. However, corporate rivalries have been so intense that it is still unusual to see cooperation or trade between members or former members of different groups.

One aspect of IFT that has given rise to much concern in the past has been TRANSFER PRICING. This involves the manipulation by firms of the price charged to and by different units within the same MNE, so as to minimize tax payments or other transaction costs. However, increased scrutiny of MNE activity and more vigorous application of multilateral trading regulations suggest that this issue is decreasing in importance, although it is still relevant in terms of the competitive conditions of particular markets. That is, scrutiny is evenly efficient in every country of the world and so there may be a disproportionately large amount of undesirable activity taking place in a small number of countries which makes those countries, generally among the poorer states in any case, making those markets less desirable still.

Over the last few decades, there has been a considerable increase in the type and prevalence of cooperative arrangements between firms, including agreements which cross borders. Two main reasons have given impetus to

this trend: first, in many countries that have recently entered the international economic order, regulations exist that require foreign firms to form joint ventures with local firms if they are to be permitted to enter. This is the case in China and Vietnam, and is also encouraged in other South-East Asian nations. Second, the complexity and rapid pace of change of technology in many sectors renders it almost impossible for any one firm to be able to control or own the range of intellectual and physical capital necessary for innovation. One particular example of this phenomenon is the SEMICONDUCTOR INDUSTRY, in which new product development is characterized by large numbers of agreements and alliances between a small number of firms – frequently with narrowly defined goals and limited timescales (see ALLIANCES, INTER-FIRM). Customarily, INTELLECTUAL PROPERTY RIGHTS (IPRs) derived from collaboration are apportioned according to a predetermined schedule among the partners, of whom there may be many more than two.

Cooperative agreements are divided between equity and non-equity joint ventures, with the former being considered a more permanent and important entity because it requires the commitment of more resources. Not surprisingly, the great majority of agreements in technology-intensive sectors involve partners from the TRIAD: the EUROPEAN UNION (EU), Japan and the United States. Such firms often undertake cooperative agreements for strategic purposes (for example, blocking other competitors or gaining access to new markets) with a view to long-term growth rather than instant profitability.

The mode of agreement that firms may choose varies considerably depending on the aims of the agreement, the resources available and the closeness of cooperation desired by the partners. These range from minority cross-holdings (exchange of equity), mutual use of RESEARCH AND DEVELOPMENT (R&D) facilities, LICENSING of technology, sharing customer-base and so forth. The complexity and ephemerality of some modes exceeds the ability of governments and multilateral organizations

to document and to apply appropriate levels of tax or responsibility for environmental protection.

Both IFT and inter-firm trade are important components of international economic activities and currently the ability to describe, analyse and make policy for them is limited by the inadequacy of classical forms of economics – the student of international political economy (IPE) must therefore draw on a range of approaches and methods of thinking.

See also:

internationalization; transnationally integrated production

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JOHN WALSH

trade, inter-industry and intra-industry

'Inter-industry trade' refers to international exchange of different products, such as the export of automobiles in return for imported clothing. Traditional international trade theory argues that if each country has a different pattern of FACTOR ENDOWMENTS and each country specializes in the production in which its relatively abundant production factor is used intensively, then it realizes the benefits of international trade. On the contrary, we see that countries with a similar industrial structure do

trade policy

more trade in industrial products and more two-way trade in similar goods. Such a matching two-way international flow of goods within the same industry has been growing more rapidly than the international flow of goods among different industry sectors.

Recent international trade theory pays attention to the growing international trade within the same industry sector. It concludes that – under conditions of product diversification, IMPERFECT COMPETITION and increasing returns to scale – the smaller the difference in factor endowments between countries, the higher will be the share of intra-industry trade with regard to total exports and imports. ‘Intra-industry trade’ is defined as the matching two-way export and import of the differentiated products within the same industry sector – that is, one country exports a commodity and imports the same type of the commodity.

The index of such trade can range from zero (indicating complete inter-industry trade in industry i) to 1 (indicating complete intra-industry trade). Germany and the United Kingdom tend to have high IIT (intra-industry trade) measures, reflecting their membership in the European Union (EU). Canada also has high indexes in relation to its trade with the United States. Japan has a rising share of IIT with South-East Asian countries, reflecting the increase of horizontal division of labour in manufacturing sectors within those countries.

The specific index used to calculate the relative share of IIT is generally defined by the equation:

$$IIT = 1 - \frac{\sum_i |Ex_i^{jf} - Im_i^{fi}|}{\sum_i (Ex_i^{jf} + Im_i^{fi})}$$

where Ex_i^{jf} is the export of country j to country f of i -th product, Im_i^{fi} is the import of country j from country f of i -th product.

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RYUHEI WAKASUGI

trade policy

Perhaps in no other area of public policy has economic theory been flouted so directly and repeatedly as in trade policy. Early economic LIBERALISM prescribed a LAISSEZ-FAIRE approach to trade policy – that is, firms and individuals should engage in international trade without interference from government restrictions on imported or exported goods. From the classical political economists to contemporary international trade theorists (see TRADE THEORY), economists have agreed that the benefits of FREE TRADE outweigh those of protection, and therefore governments should maintain a policy of free trade. And yet governments have generally not followed policies of free trade; rather, protectionism in one form or another (including TARIFFS, QUOTAS, export SUBSIDIES and NON-TARIFF BARRIERS (NTBs) such as VOLUNTARY EXPORT RESTRAINTS (VERs), ORDERLY MARKETING AGREEMENTS (OMAs) and – arguably – local content, product-safety, health, environmental and other regulations) has been the norm. The question of why governments choose policies of protectionism over free trade lies at the heart of the literature on the POLITICAL ECONOMY of trade policy. The simple answer is that the choice of protectionism over free trade is motivated by *political* not economic logic – and so one must analyse the motivations of political actors.

Although free trade enhances the WELFARE of the economy as a whole, some individuals and firms suffer from the exposure to trade at world prices while others gain from such exposure – in short, there are losers and winners from international trade. The losers, when they are politically influential, will tend to persuade government of the need for protection. Even those groups that are not harmed by international trade may seek to influence trade policy so as to create rents for themselves (see RENT SEEKING). In short, trade flows have income-distributional consequences that organized groups and individual voters seek to influence through trade policy.

Admittedly, governments use trade policy to achieve a number of goals beyond redistributing income. Through trade policy, governments may seek to create jobs (or alleviate unemployment); improve the overall standard of living; enhance national security (which may include strengthening alliances with friendly states, depriving rival states of economic resources, limiting the spread of military weapons, and ensuring domestic supplies of vital resources such as oil and food); gain a strategic or competitive advantage over other states; protect infant industries (see INFANT-INDUSTRY PROTECTION); influence the domestic policies of other states (for example, on human rights, emigration, environmental issues); and facilitate other domestic policy objectives (for example, preservation of the environment, health and safety standards). Yet the trade policy literature largely overlooks the multiple and often contradictory goals of politicians who formulate trade policy. Rather, a simplifying assumption is that the primary goal of politicians is to gain or retain public office, which is achieved by maximizing their net political support. Their strategy is to maximize a political support function which trades off the gains (in the form of votes or campaign contributions) they receive from protection of particular industries against the losses (in the form of votes) to the general population. (The literature offers little insight into why politicians, in their quest to maximize net political

support, choose trade policy over more efficient means of redistributing income.)

Once the supply of protection by politicians is modelled, questions then arise as to what determines the demand for protection. Two questions are particularly relevant: Which groups seek protection and, among these, which ones tend to be more successful? The answer to the first question depends on whether factors of production (the most basic being land, labour and capital) are mobile between sectors or are specific to industries. Trade theory offers two models of the gainers and losers of protection. In the Heckscher–Ohlin model, factors are mobile between sectors. The Stolper–Samuelson theorem then posits that protection increases the real income of owners of the relatively scarce factor at the expense of owners of the relatively abundant factor. We should then expect to see conflicts over trade policy arising between owners of different factors: for example, if capital is scarce and labour abundant, capitalists will favour protection while workers will favour free trade. A second model, the Ricardo–Viner specific factors model, defines some factor inputs as industry-specific and others as intersectorally mobile. Industry-specific factors give rise to industry-specific interests that may either favour or oppose protection, depending on the form of trade competition facing the industry. Owners of factors specific to the domestic import-competing industry gain from protection, while owners of factors specific to the export sector lose. The preference of the mobile factor owners (usually labour) is ambiguous: although they can move into the protected sector, their welfare remains contingent on their unique CONSUMPTION preferences. Owners of factors specific to a particular industry will tend to seek protection for their industry and oppose protection for any other industry, while mobile factor owners will remain largely inactive. These two models may be bridged by introducing a temporal dimension – that is, if intersectoral factor immobility is a short-run characteristic, then the Heckscher–Ohlin–Stolper–Samuelson model identifies the interests of factor owners

in the long-run, while the specific factors model identifies their interests in the short-run. Whether factor owners are motivated by long-term or short-term interests remains an unanswered question, although much evidence points to the latter.

The empirical literature on the political economy of trade policy suggests that coalitions seeking to influence trade policy form along industry rather than factor lines. Hence, our second question is modified to ask: Which *industries* tend to be more successful in obtaining trade protection? Empirical findings suggest that successful industries tend to be labour-intensive, low-skill, low-wage, with high or increasing import penetration, producing consumer rather than INTERMEDIATE GOODS, have production concentrated in a few firms, are highly unionized, have consumers that are not highly concentrated, and have less intra-industry trade (see TRADE, INTER-INDUSTRY AND INTRA-INDUSTRY; UNIONIZATION).

The literature on the political economy of trade policy has gained many insights from PUBLIC CHOICE (PC) THEORY, particularly in specifying the interests of political actors and the strategic setting in which they operate. However, the focus on interests has often hindered the theoretical and empirical exploration of two other determinants of trade policy: institutions and ideas. While protection may be modelled as the equilibrium obtained from simple supply-and-demand conditions, such models fail to capture how institutions shape the preferences and actions of politicians, voters, interest groups and political parties. For instance, questions as to why countries adopt very different trade policies, why a single country abruptly reverses its trade policy, and why a country continues to pursue a trade policy that is clearly inconsistent with the interests of relevant political actors, all defy explanation without some recourse to institutional context. Two classic examples demonstrate how institutions can significantly affect trade policy. First, in nineteenth-century Britain, electoral reform in 1832 gave representation and political momentum to free-trade interests which, in part, paved the way for a

fundamental shift to free trade in 1846, with the repeal of the protectionist CORN LAWS. Second, in the Reciprocal Trade Act of 1934, the US Congress recognized its inability to withstand protectionist interests and consequently delegated to the president the authority to negotiate tariff reductions. Delegation, as an institutional innovation, thus allowed the president to engage in tariff-reducing bilateral and multilateral TRADE AGREEMENTS. One reason why political economy models of trade policy are deficient in explaining variations in trade policies across countries and over time is that most begin with the framework of modern democratic institutions, modelled mostly on the American case. As researchers extend the institutional analysis of trade policy to include other countries' trade policies, both contemporary and historical, a better understanding of how institutions intersect with the interests of political actors to shape trade policy is likely to emerge.

A second deficiency in the literature is its difficulty in explaining how ideas about economic policy intersect with interests (and, for that matter, with institutions) to affect trade policy. For example, ideas about how international trade influences broader national goals – such as the nation's security (for example, preserving the nation's food supply or maintaining industries deemed essential to military power) – or how it overlaps with other domestic policies such as environmental protection, clearly enter into the decision-making calculus of politicians. Yet these considerations are often ignored by researchers. Moreover, industries seeking to influence trade policy often characterize their policy objective as beneficial to societal welfare in order to capture the support of consumers and taxpayers. For instance, farmers often attempt to persuade the electorate of the need for agricultural protection in as much as farms are a way to preserve the scenic countryside or maintain rural values (emphasizing the family and community). Such use of ideas by interest groups to shape the preferences of voters (and politicians) is generally relegated to anecdotal asides.

As a final comment, it should be noted that

agreement on the welfare-enhancing effects of free trade has been shaken by the theoretical elegance of STRATEGIC TRADE THEORY. In the early 1980s, some economists developed an analytical justification for government promotion of certain domestic firms. It was argued that the goal of such promotion (which would include protectionist policies such as subsidies) would be to shift profits from foreign firms to domestic firms and thereby increase national wealth. However, the policy implications of strategic trade theory were found to be highly sensitive to changes in the theory's assumptions (for example, that the international market would remain a fixed DUOPOLY, with no possibility of new competitors eliminating the extra profits). While its intellectual challenge to free trade seemed formidable, its practical relevance to policy-makers has been limited by its unrealistic and confining assumptions. Hence, the force of free trade, both at the level of theory and policy prescription, remains intact – challenged only by the political case for overriding the logic of the economic rationale.

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CHERYL SCHONHARDT-BAILEY

trade regimes

A 'trade regime' is the posture of a national government towards international trade and the expression of this in the form of legislation and regulations. Trade regimes vary from protectionism to support of LAISSEZ-FAIRE free-market policies, and governments may be located anywhere along this continuum. Neo-classical economists historically believed in free trade and regarded any impediments to this as being counter-productive (see NEO-CLASSICAL ECONOMICS). However, more recent thought focuses on market imperfections and the need

trade surplus

for governments to intervene to counteract these. The rise of the East Asian economies has lent more support to the value of a regime that promotes outward links (exports), while inhibiting inward links (imports) – at least until policy and developmental goals are reached.

See also:

East Asian model; imperfect competition

JOHN WALSH

trade surplus

International trade is the exchange of goods across national borders. Exports are domestically produced goods sold to other countries. Imports are goods bought from other countries. Thus, one country's export is another country's import. The **BALANCE OF TRADE** is the relationship between a country's exports and imports. A balance-of-trade surplus occurs when net exports are positive – that is, when a country exports more goods and services than it imports. Conversely, a balance-of-trade deficit occurs when net exports are negative – that is, when a country imports more goods and services than it exports.

M. PETER VAN DER HOEK

trade theory

Trade is one of the oldest forms of interaction between states and as such is at the heart of the study of international political economy (IPE). From the beginnings of industrialization, trade has assumed an ever larger role in ensuring the continued prosperity of a nation. Moreover, since World War II, the political and economic significance of trade has greatly expanded, heightening the academic and public debate regarding its importance. This is particularly the case with regard to the impact of trade on the domestic politics of a state. Trade issues have an impact on a wide range of domestic

interests. Because the economic success of such interests is, to a large extent, determined by a state's policy position over trade matters, trade is often the focus of numerous domestic political conflicts.

Trade is the exchange of goods (and increasingly services) between one state and another. Such exchange takes place because it enhances the economic **WELFARE** of a state by (1) reducing the prices of goods and services, and (2) increasing the range of goods and services available for **CONSUMPTION**.

Differing theoretical perspectives on IPE will provide different motivations regarding the nature of trade. One of the most significant is the liberal concept of trade, developed initially by **ADAM SMITH** and **DAVID RICARDO**, which treated labour as the only input into the production process. Smith believed trade to be the result of '**ABSOLUTE ADVANTAGE**'. States that could produce a particular good or service at lower cost than other states have an absolute advantage in production. States benefit by specializing in the production (and export) of those goods where they enjoy an absolute advantage in production and by importing goods where an absolute advantage is not enjoyed – that is, where domestic production is more costly than the equivalent imports.

Ricardo extended Smith's analysis through his realization that states need not have an absolute advantage in production, but only a '**COMPARATIVE ADVANTAGE**', in order to benefit from trade. A state has a comparative advantage in producing a particular good or service if the opportunity cost of production is lower than in other states. Therefore, one state does not need to have an absolute cost advantage in the manufacture of a particular product for that state to be able to find another state willing to trade with it. Even if it were more costly for a particular state to manufacture all products, a state will benefit from trade by specializing in the production of the good for which its absolute disadvantage is smallest.

One drawback of Ricardo's theory is that it is based on a version of the **LABOUR THEORY OF VALUE**. This shortcoming is remedied in a number of modifications of the theory of

comparative advantage, the best known of which is the Heckscher Ohlin model (see HECKSCHER–OHLIN–SAMUELSON (HOS) MODEL OF TRADE). This theory predicts that a state will have a comparative advantage in the production of goods produced using inputs that exist in relative abundance. Therefore, a capital-rich state will produce and export capital-intensive goods, while a labour-rich state will produce and export labour-intensive goods.

The above theories of trade may adequately explain trade in different types of goods – that is, inter-industry trade. However, much trade consists of the import and export of very similar goods – that is intra-industry trade (see TRADE, INTER-INDUSTRY AND INTRA-INDUSTRY). For example, the United Kingdom simultaneously imports and exports family cars, beer and chemicals, among many other goods. Many competing theories of intra-industry trade exist, but some general themes are highlighted below.

One broad group of models assume goods to be horizontally differentiated – that is, varieties of essentially similar goods tend to have slightly different characteristics. These differences may be real or perceived, and it is assumed that consumers gain utility from variety of choice. Consumers wishing to maximize their utility of consumption will buy both domestically produced and imported goods that are essentially similar, but differentiated in some way. A related group of theories are built on the assumption that consumers have diverse preferences and are likely to buy several different varieties of goods in an attempt to obtain a bundle of goods that most closely matches their preferences. Consumers are therefore likely to purchase goods from both home and abroad in the attempt to obtain their optimal bundle.

Another factor important in the explanation of intra-industry trade (and also inter-industry trade) is the existence of ECONOMIES OF SCALE. The existence of exporting opportunities allows firms to expand the scale of production and reduce relative prices, resulting in further gains from trade. The existence of economies of scale in oligopolistic markets (see OLIGOPOLY) also

may result in the trade of identical products (that is, intra-industry trade) as firms attempt to increase profits by selling abroad as well as in the home state. This is likely to push prices downwards in comparison to a position where national monopolists provide for their own domestic market.

This brings us to a related point: trade may be beneficial simply because it results in an increase in international competition (see COMPETITION, ECONOMIC ROLE OF). Increased competition may stimulate greater EFFICIENCY in domestic production and prevent domestic monopolies/oligopolies from charging high prices. It may also provide an incentive for firms to be more innovative in order to maintain their market presence, thus stimulating greater RESEARCH AND DEVELOPMENT (R&D) and the more rapid adoption of new technology. This, in turn, may lead to a greater variety of products being made available to consumers. In addition, there may be political, social and cultural advantages to be gained by fostering international trading links between states, such as emphasizing an alliance relationship or building a new bilateral partnership.

Using trade strategically (see STRATEGIC TRADE THEORY) in this manner can be seen in the policies of MERCANTILISM that dominated during the sixteenth to eighteenth centuries, although mercantilists advocated government control of TRADE POLICY. This was seen as a means of achieving the accumulation of wealth and power that was seen as vital to a state's national security interests. This later developed into an examination of the domestic factors that would improve a nation's power position, with economic nationalists such as ALEXANDER HAMILTON and FRIEDRICH LIST advocating state protection from 'unfair' competition and government promotion of domestic industries.

The liberal ideas of Adam Smith and David Ricardo regarding trade (discussed above) came as a reaction to these policies of mercantilism and the nineteenth century saw their FREE TRADE ethic inducted into the behaviour of both governments and business elites. Indeed, the end of the Napoleonic Wars

gave the international system the tranquillity it needed for trade to prosper and this time saw tremendous increases in the level of trade.

This liberal philosophy was replaced, however, in the years between World War I and World War II, when trade became highly protectionist once more, with states seeking to insulate their economies from the gloomy economic outlook prevailing at that time. States practised protectionism in trade – the SMOOT–HAWLEY TARIFF in the United States being an example of this in its most extreme form.

Nevertheless, the doctrine of free trade was revived in the post-World War II period, in particular in the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) of 1948, which grew out of the Bretton Woods agreement's desire to create an international institution that would promote free trade (see BRETTON WOODS SYSTEM). (It was also built somewhat on the work of the ill-fated HAVANA CHARTER.) GATT had a degree of success in reducing tariffs on manufactured goods, but there remain a number of issues of protection which have yet to be solved by the WORLD TRADE ORGANIZATION (WTO) that took over GATT's role in 1995. One of these is the reviving use of strategic trade policies. Such policies grew in significance over the 1980s and 1990s. The idea behind them is that a state's comparative advantage is not permanent. Rather, a state can use a combination of policies – such as protectionist measures and the subsidization of specific industries – in order to create a comparative advantage in the manufacture of a particular product. Such policies result from the fundamental political differences that pit local oligopolists and national governments against their counterparts in other countries. This can have a dramatic impact on a state's relationships with other states and thus is one of the more recent factors that has served to highlight the increasingly political impact of trade.

Likewise, trade can be used more directly as a tool of foreign policy. During the COLD WAR, for example, access to the US market was used as an enticement away from COMMUNISM; trade

sanctions (see SANCTIONS, ECONOMIC) or the threat of trade sanctions have also been used as a tool to punish nations taking a foreign-policy stance with which a state or group of states did not agree.

The use of trade in such a way, as a foreign-policy tool, is something that has a long history, but whose scope has grown over time. The modern use of economic sanctions was pioneered largely by the League of Nations, as the question of how the League's decisions were to be enforced was endlessly discussed prior to the drafting of the Covenant and through the entire period of the League's existence. Both the League and the later UNITED NATIONS (UN) used sanctions as instruments in the pursuit of collective security goals. However, although the collective security rationale for trade sanctions is still important, many countries now incorporate sanctions into their foreign-policy actions as a routine method of attaining national strategic or economic policies. This is particularly the case given the destructive nature of modern warfare.

Another recent development in trade that has highlighted its political significance is the increasing proliferation of regional economic groupings. In many ways the template for these has been the success of the EUROPEAN ECONOMIC COMMUNITY (EEC) – now EUROPEAN UNION (EU) – founded in 1957. Since that time, there has been a wide array of new regional arrangements in all parts of the world, including the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) and the ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN). While these unions do establish free trade between member-countries, they often discriminate against those countries not in the arrangement by practising essentially protectionist measures (see CUSTOMS UNION (CU); FREE TRADE AREA (FTA)).

Trade, then, has grown rapidly since the end of World War II and many changes in the form of goods traded have taken and are currently taking place. For example, for those countries still undergoing a process of DEVELOPMENT, trade is an important engine of growth. Indeed, in an attempt to achieve faster levels of

economic growth, developing countries are changing from simply being raw materials exporters, to being exporters of finished or semi-finished goods. Trade is a controversial subject for LESS-DEVELOPED COUNTRIES (LDCs), however, because of the controversies regarding the distribution of the gains made from trade. In particular, it is often felt that developing countries are at a disadvantage in comparison to their developed country trading partners, something about which structuralists (such as the world-systems theorists) are increasingly concerned. This is particularly the case given that developed countries are taking advantage of technological specialization, so that trade in high-value finished manufactures is increasing between them.

See also:

multinational corporations (MNCs); strategic partnership; structuralism; tariffs; terms of trade; world-systems theory

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PETER MACMILLAN

trade unions

Trade (or trades) unions have been defined as 'a continuous association of wage earners for the purpose of maintaining or improving the conditions of their working lives' (Webb and Webb, 1894: 1). Trade unions first emerged in Victorian Britain, during the latter half of the nineteenth century, when skilled craft workers combined to form organizations to protect their interests both by restricting entry to their trades and by bargaining with their employers on a collective rather than an individual basis. By 1914, trade-union membership in the United Kingdom had risen to more than four million, or nearly one-quarter of the employed population, compared to only 4 per cent in 1880 (Hinton, 1983: 24). Trade unions subsequently arose in later industrializing economies, notably Germany, France, the United States and Scandinavia, and were instrumental in the creation of universal suffrage, social democratic political parties, managerial capitalism, mixed economies and welfare states (see SOCIAL DEMOCRATIC PARTIES; WELFARE STATE). More recently, trade unions have been at the forefront of struggles against oppressive regimes and totalitarian states, notably in apartheid South Africa and communist Central and Eastern Europe.

In capitalist economies, trade unions have been confronted with a number of dilemmas concerning their organization and strategies. First, whether they should protect and improve their members' pay and working conditions through simple economism (that is, collective bargaining with employers) or through active participation in the wider political process. Second, whether they should ally themselves with established political organizations or form their own separate political parties. Third, whether they should associate themselves with the established political process and state structures or agitate for political transformation or revolution to replace CAPITALISM with a socialist or communist utopia (see SOCIALISM; COMMUNISM).

Many union movements did associate themselves with political transformation and revolutionary politics at the end of World War I. Trade unions played a key role both in the establishment of communist regimes and in resisting the rise of FASCISM in Europe. However, in both the Soviet Union under Stalin and Germany under Hitler, independent trade unions were liquidated and replaced by official workers' organizations that became mere adjuncts of the authoritarian state.

In studies of rival post-war cultures of capitalism, while the presence of disruptive trade unions has been identified as a cause of relative economic decline in the United Kingdom, in competitor economies unions have been seen as a source of competitive advantage. For example, in post-war Japan, trade unions in large companies have not been organized on the basis of either individual crafts or industries but at the level of the individual company. This form of labour organization (and the post-war system of cooperative worker co-determination practised in West Germany) has been held to have been more productive than the more antagonistic system of union-management relations in the United Kingdom.

The average number of working days lost per year in the United Kingdom due to strike action was 3.5 million in the 1960s, but this rose to an annual average of 12.9 million in the 1970s (Deakin, 1992: 176). This level of strike activity was labelled the 'British disease' and widely cast as the root cause rather than the inevitable consequence of the United Kingdom's relative economic decline. When the Thatcher government took office in 1979, it saw 'solving the union problem' as the key to British recovery. The presence of a politicized and Luddite trade union movement was seen as one of six main obstacles to full employment and prosperity (along with high state-spending, high direct TAXATION, egalitarianism, nationalization and the presence of an anti-enterprise culture).

During the 1980s, the Thatcher governments repeatedly legislated to discipline and ultimately weaken the trade unions' political power and capacity for collective bargaining,

removing many of their historic legal immunities and broadening the sanctions that could be brought against them and their membership. Union membership in the United Kingdom fell by 24 per cent from its post-war peak of 13.3 million (or 51 per cent of the total workforce) in 1979 to 10.2 million (or 37 per cent) in 1989 (ibid.: 179). This trend was reflected across other ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries as a consequence of the onset of recession and higher unemployment.

Despite the Thatcherite trade union reforms, the level of strike activity in the United Kingdom during the 1980s remained twice that of the 1960s, at an annual average of 7.2 million working days lost. However, by the time of the 1997 UK General Election, in Thatcherite terms the trade union problem had been solved. The 1997 Conservative Party General Election manifesto celebrated the fact that 300,000 working days had been lost to strikes in the United Kingdom in 1994, compared to 29.5 million in 1979. Indeed, in 1998, the United Kingdom had its second lowest ever strike rate: a mere 12 working days lost per 1,000 employees, compared to the OECD average of 45 days lost and the EUROPEAN UNION (EU) average of 48 days lost.

Trade union reform has not resulted in the predicted improvement in UK labour productivity. Although hourly labour productivity in UK manufacturing rose by 4.7 per cent from 1979–89, it has been calculated that 51.6 per cent of this increase was accounted for by lower employment in manufacturing (which fell by 26 per cent). More recently, labour productivity in the United Kingdom (measured in terms of output per hour worked) for the period 1994–6 was found to be 37 per cent less than in the United States and 26 per cent less than in West Germany and France. The fact that both highly unionized and lightly unionized economies remain far more productive than the United Kingdom demonstrates that there remains little empirical basis for any correlation between the level of trade union membership, labour productivity and national economic performance.

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SIMON LEE

trade-related intellectual property rights (TRIPs)

The 1994 agreement on trade-related intellectual property rights (TRIPs) incorporates much of the Paris and Berne Conventions administered by the WORLD INTELLECTUAL PROPERTY ORGANIZATION (WIPO) into the WORLD TRADE ORGANIZATION (WTO). Once transition periods extended to the DEVELOPING COUNTRIES and ex-communist states have passed, the TRIPs agreement harmonizes the INTELLECTUAL PROPERTY RIGHTS (IPRs) regimes of signatories, including eligibility for protection and its duration. These obligations must be reflected in domestic law, though there is considerable organized resistance to such legislation in some developing countries. International disputes over intellectual property protection are now subject to the stringent cross-sectoral enforcement system of the WTO.

CHRISTOPHER MAY

trade-related investment measures (TRIMs)

Trade-related investment measures (TRIMs) are aspects of state policy that aim to control the behaviour of foreign investors. While not directly concerned with price (like TARIFFS), TRIMs attempt to shape foreign trade to the domestic government's economic policy. The most common TRIMs are export-performance requirements, ensuring foreign currency earnings as well as reducing the competitive pressure on domestic companies, and local content provisions to support local supplier networks. The TRIMs agreement during the URUGUAY ROUND confirmed that the provisions of the WORLD TRADE ORGANIZATION (WTO) covered investment regulations when they had a direct impact on international trade, though this had not always been accepted by DEVELOPING COUNTRIES.

See also:

foreign direct investment (FDI)

CHRISTOPHER MAY

tragedy of the commons

The 'tragedy of the commons' is a metaphor used to describe many international environmental and resource-use issues. In particular, it refers to the 'international commons' – those areas that are not within the jurisdiction of a particular state, but are held by humanity in common, including the high seas, the upper atmosphere and those parts of the environment that are held to be part of the human heritage. The metaphor is used to describe situations in which COOPERATION between states would lead to optimal outcomes for everyone, but in which individual incentives are to overuse resources or overpollute, leading to environmental degradation. Since there is no higher authority to enforce cooperation in international politics, agreements are difficult to enforce and the

tragedy of the commons

individual interests therefore often win out over the COLLECTIVE GOOD. Many analysts argue that this COLLECTIVE ACTION problem is best dealt with by privatizing those parts of the international commons and, where PRIVATIZATION is not feasible, by international institutional mechanisms that can gather the information necessary for efficient management of the commons, by impartially set rules of behaviour that states will accept as fair, and by effectively monitoring and enforcing those rules.

Garrett Hardin, in his 1968 article entitled 'The tragedy of the commons', introduced the metaphor into international environmental analysis. He used it to refer to medieval farming practices, in which grazing land was not privately owned but held by villages in common. All residents of the village could graze their livestock on the village common, which could effectively feed only a limited number of animals. It was in the common interest of the villagers to ensure that only this number of animals and no more were held by villagers and grazed on the common, because to introduce a greater number would lead to all of the villagers' animals being underfed. Yet, at the same time, it was in the interest of each villager to introduce more animals, because if they did so it would significantly increase family wealth without putting much extra strain on the commons. In other words, the villager would gain all of the positive effects of the introduction of new animals, while all of the villagers would be forced to share in the negative effects. If everyone behaved in this way, it would lead to a serious deterioration of the commons, and in turn to generally underfed livestock and thus to increased poverty all around. The tragedy is that individual greed, in this case, leads to collective impoverishment.

This situation is a variant of what MANCUR OLSON called 'collective action problems'. In INTERNATIONAL POLITICAL ECONOMY (IPE), a tragedy of the commons situation exists where humanity would benefit from the sustainable management of an environmental good, but particular countries have individual incentives

to overuse the good in the hope that others will act responsibly (or for fear that other countries will not act responsibly anyway, so that individual responsible action will be to no avail).

Hardin himself used the tragedy of the commons metaphor to refer specifically to global population growth, but there are a variety of different types of international commons issues. Perhaps the classic international commons situation concerns resources found in the high seas. The management of fish stocks in the high seas, for example, has led to international conflict for centuries and continues to do so. It is not only resource issues that are prone to tragedies of the commons, though: pollution of the commons can lead to the same result. A number of issues relating to another international commons, the upper atmosphere, fall into this type: two of these that are particularly politically salient are the introduction into the upper atmosphere of unsustainable quantities of ozone-depleting substances and of greenhouse gasses. A third type of international commons issue is to be found in those environmental goods that benefit all of humanity wherever they happen to be physically located. An excellent example of this kind of common good is biodiversity. Many scientists argue that the preservation of biodiversity is necessary for the long-term health of the global ecosystem and, by extension, of humanity. Yet it is in the short-term economic interest of individual countries to exploit resources in a way that diminishes biodiversity, in the hope that the broader good will be protected elsewhere. As a result, biodiversity in general goes largely unprotected and species are becoming extinct at an alarming rate.

The most direct response to a tragedy of the commons situation is privatization – in other words, dividing up the resource held in common into parcels privately owned by individuals. This is how the inefficiency of the village commons system was dealt with in England: by ENCLOSURES. This strategy is often attempted in the international commons. An important example of this strategy was

creation of 200-mile Exclusive Economic Zones, that extend national jurisdiction over maritime resources much farther out to sea than had previously been the case, bringing the bulk of such resources within national control. Another example is agreements that guarantee to governments royalties from drugs produced by species found on their territory, thus giving those governments private benefit from the resource of biodiversity. There are two problems with the strategy of privatization, though. The first is that national governments, when given private jurisdiction over resources, often then fail to manage them sustainably (as is frequently the case with fisheries management). The second is that many international commons, such as the upper atmosphere or species that migrate across national jurisdictions, cannot be meaningfully (or cost-effectively) privatized.

A more common response is the creation of international institutions that act to address international MARKET FAILURE by creating appropriate incentives for sustainable management of the international commons, following the approach to international institutions developed by ROBERT KEOHANE. These institutions fulfil three functions. They help to create the information necessary for the most efficient management of the environmental good in question; they help to disseminate that information; and they create clear and transparent mechanisms for both decision-making and adjudicating in issues relating to the levels of resource usage allowed both in total and to individual countries. A good representative example is the secretariat of the Montreal Protocol on Substances that Deplete the Ozone Layer, which has a scientific element that determines which chemicals need to be controlled, a set of clear rules about what behaviour is expected of signatory states and a financial mechanism to assist poorer countries with the costs of compliance. This reduces the collective action problem that otherwise would lead to a tragedy of the commons by helping to convince states that the issue is being dealt with both as efficiently and as fairly as possible.

There are three directions from which the use of the tragedy of the commons as a metaphor for international environmental issues has been criticized. One is that it focuses too much on states, treating them as if they were the people actually using the resource in question, when in fact it is the behaviour of individuals that is ultimately responsible for environmental damage. Because the tragedy of the commons approach treats states as rational unitary ACTORS, as if they were people, it cannot deal with the realm of domestic politics, where much of the international behaviour of states is determined. A second avenue of criticism is that this rationalist approach treats states not as real people, but as strictly economic actors. Such critics would point out that village commons are often adequately managed, because they are run by social groups, rather than autonomous economic agents interacting to maximize individual utility, and thus sociological rather than economic tools are necessary to describe the management of their common resources. By analogy, economic analyses of the management of the international commons should be supplemented by sociological analyses. The third criticism of the use of the tragedy of the commons metaphor is that it assumes that all states agree on the ultimate goal – on what a well-managed international commons would look like. This assumption is reasonable for a village common: all the villagers depend on it for their basic livelihood. It is not necessarily reasonable for all international commons issues, though. A salient example is whaling. If some states see whales as sentient creatures needing protection as individuals and others see them as a food source, then the management of whaling is more a question of which world-view prevails than it is of finding efficient institutional mechanisms.

See also:

anarchy, international; chlorofluorocarbons (CFCs); environment: environmentalism: externalities; global warming (UN Climate Change Convention); international organizations (IOs);

Trans-Atlantic Free Trade Area (TAFTA)

limits to growth; neo-Malthusianism; regime theory; sustainable development

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J. SAMUEL BARKIN

TRANSATLANTIC ECONOMIC

PARTNERSHIP (TEP) see Trans-Atlantic Free Trade Area (TAFTA)

Trans-Atlantic Free Trade Area (TAFTA)

The idea behind the Trans-Atlantic Free Trade Area (TAFTA) was the establishment of a COMMON MARKET between the United States and the EUROPEAN UNION (EU). first broached in the 1960s but overtaken by the KENNEDY ROUND of multilateral trade negotiations. The notion had a renaissance in the mid-1990s, under a joint British, German and Canadian initiative, and was reformulated later in the decade as the New Transatlantic Marketplace Agreement (NTMA). Finally, under the influence of the EU in concert with the United States, it became the joint Transatlantic Economic Partnership (TEP) initiative. The institutionalization of the WORLD TRADE ORGANIZATION (WTO) and concomitant di-

vergence of EU and US strategies under GLOBALIZATION has put such an initiative into question.

ROBERT M. CUTLER

transfer pricing

Within multi-site companies, the movement of items between different locations is accounted for by internal 'transfer prices'. When production takes place within a single plant or factory, component movements are seldom controlled by accounting procedures, but few large companies complete all production processes in the same location. Once an enterprise has a number of plants, each of which conducts a discrete part of the production process, the flow of items from plant to plant is tracked by formal invoicing. The preparation of management accounts involves the computation of a transfer price to establish the economic performance of different factories or plants within the overall organization of production. This enables managers to ascertain each plant's productivity or EFFICIENCY, as well as keeping records of the movement of items between locations. When these transfers of unfinished items are between locations in the same state, they are of little interest to national taxation authorities. All internal transactions taking place within the state's jurisdiction will be included in the final annual accounts and profit will attract taxation on the basis of the company's activities as a whole.

However, with the development of an international DIVISION OF LABOUR within transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)), components that make up the final product may be manufactured by the company in different countries. Transactions between these locations will still be tracked by internal record-keeping. But, as each national division reports to the tax authorities governing the state in which it is located, these transactions now appear in annual accounts as sales or inputs and contribute towards the taxable

profit in that jurisdiction. Around a third of the volume of world trade takes place within MNCs rather than between companies and customers, reflecting the importance of this international division of labour. But, while these goods contribute to the volume of world trade, their contribution to the value of world trade is much more difficult to measure. Transactions within companies take place on the basis of internal accounting protocols and the results of these protocols have a major impact on the nominal profitability of different national divisions.

The transfer between national legislations on the basis of internalized price structures obscures the value of these exports and imports from national tax authorities. The effects of transfer pricing can be inferred, but the actual transfer prices are not open to scrutiny. Indeed, companies regard these prices as sensitive commercial information. This secrecy has led to frequent accusations that MNCs use transfer pricing to avoid tax liabilities. By careful setting of the price of goods transferred from division to division, particular national operations can produce public accounts that are tax efficient. When there are significant differences between tax rates or differences in criteria for taxation, it is in the interests of MNCs to take their profits where they will attract the least taxation, or where they have received TAX HOLIDAYS in return for inward investment and are not liable to taxation at all. Companies may also want to move the value-added between their divisions for non-taxation reasons that include the need to: support capital investment in a particular location; lower reported profits to mitigate national claims for wage increases; support a new venture by lowering its input costs, allowing it to compete on the basis of lower prices in that market; or defray exchange-rate changes. However, while the underlying motives for transfer-price manipulation may be internal or external, the result of such manipulations is always a concern for tax authorities.

Though formally illegal in some jurisdictions, manipulation of transfer prices allows MNCs to substantially reduce their overall tax

burden. Where taxation is high, the price of foreign transfer of components may be adjusted to only cover internal costs and the division does little more than break even. The contribution to the final value-added which the component represents is transferred at no cost to the next division. However, where tax rates are low or non-existent, then the transfer price may be inflated. This pushes up the costs at the next stage, where tax rates may be higher, and transfers value-added back down the internal supply chain to the low tax location. Transfer of value may also take place through internal charges for the use of PATENTS and trademarks, and thus payments may be made to a particular division located in a low (or zero) tax jurisdiction for the use of processes owned by the company or for the use of trademarks. Essentially, profits are likely to be taken within whichever jurisdiction attaches least taxation to them. Studies of the low levels of multinational corporate tax liabilities suggest this practice is widespread.

Given the internal nature of transfer pricing and the assertion by multinational management teams that only they are in a position to assess the correct price to transfer goods in their internal market, this remains a serious problem for tax authorities. If MNCs were to report their global accounts to one global tax authority, with their global operations being treated as single entities for tax purposes, then their tax liabilities might be better gauged. However, the problem of legitimate jurisdiction and authority this would represent has yet to be surmounted. Alternatively, as the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) (1979) has argued, a clear 'arm's-length' principle – with prices set on the basis of what the divisions would sell goods for between themselves in an open market – allows taxation assessment to reflect the value generated by national operations. This standard has been adopted by the tax authorities of most developed states, but is difficult to effectively police. And as long as national jurisdictions continue to compete with each other to attract FOREIGN DIRECT

transformation curve

INVESTMENT (FDI) from MNCs, the problem of tax-efficient transfer pricing will remain.

See also:

joint ventures; division of labour, spatial; tax policy; trade, inter-industry and intra-industry

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CHRISTOPHER MAY

transformation curve

For a given amount of physical and human resources and a given TECHNOLOGY, the 'transformation curve' portrays the *maximum* attainable output combinations of any two commodities, A and B, when all resources are fully and efficiently employed. The transformation curve is also called the 'production possibility curve'.

Suppose that (under unchanged technology) the quantity of physical and human resources is doubled, either as a result of INVESTMENT improving the quality of the existing resources or of investment in new resources. This doubling of resources will cause the entire transformation curve to shift uniformly outward. More goods of both A and B can potentially be produced. It thus follows that

the GROSS NATIONAL PRODUCT (GNP) is able to increase.

In the case where only capital, land or labour increases in quantity or quality, the transformation curve will not shift uniformly outward. This is called a situation of 'unproportionate growth of production factors'. If, for example, A uses capital as the intensive production factor, the shift in the transformation curve will be more pronounced for A when capital increases relatively.

N.M. DUYKERS

transformation economies

Transformation economies can be described as countries which are in a transition from one economic and social system to another. Typical examples of transformation economies are those countries in Eastern Europe that are undergoing the transition from a centrally planned economy (see COMMAND ECONOMIES) to a market-driven economy. In general, there are two polar strategies for transformation: (1) the new system can be implemented at once, following shock therapy, or (2) it can be introduced step by step, according to a sequencing procedure.

Crucial elements of the economic policy in transformation countries are PRIVATIZATION, price LIBERALIZATION, restructuring of the economy and macro-economic stabilization. An important step towards a market economy is to privatize former STATE-OWNED ENTERPRISES (SOEs) and to support the launching of new companies. Governmental price-setting and -subsidizing has to be replaced by price liberalization in order to support macro-economic stabilization. The restructuring of the economy requires access to private capital. Sources of capital are domestic savings, as well as inflows from foreign investors (such as direct investments). An effective macro-economic stabilization policy includes balancing the government budget to reduce the inflationary potential of fiscal deficits and the implementa-

tion of a nominal anchor, like money supply growth or a FIXED EXCHANGE RATE.

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GABRIELE MEINERT

transshipment

'Transshipment' refers to the common practice of re-exporting and re-routing goods and commodities that have been shipped into a country, without further processing. 'Free-trade' ports, such as the Free Port in Malta, have often been established to facilitate such transshipment with the minimum of customs' formalities. Transshipment also constitutes a significant portion of the trade of a number of the world's smaller trading nations, particularly that of Singapore.

See also:

re-exports

R.J. BARRY JONES

transition theorists

The goal of the process of transition of the Eastern European countries since the collapse of the Soviet Union is the establishment of a market economy. Besides changing the rules, what is important in this process of transition is the behaviour of the economic subjects and their reactions to the implemented policies.

This aspect of economic transition is crucial to the differences between the two theoretical schools of transition, which are labelled differently by different authors: the first category are the shock-therapists, constructivists or radicals; the second is the gradual transitionists, Popperians or evolutionaries. The former have a clear idea of capitalist social relations – that

is, private property and a free market – and wish to establish this model as quickly as possible. Following Karl Popper (1902–94), the latter argue that a substantial transformation inevitably takes time. They emphasize that, in the process of socio-political transformation, one needs to take into account the concrete situation in specific countries and the unintended effects that policies might produce. This process may take decades and there is no guarantee that it will succeed.

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MEHDI PARVIZI AMINEH

transmitted effects

The term 'transmitted effects' refers to the changes in economic activity that occur over time following a change in the money supply. This process varies considerably depending on whether one takes a Keynesian or monetarist view of the process (see KEYNESIAN ECONOMICS; MONETARISM). In each case, the effects may be further transmitted through the international economy.

The effects of monetary policy on the economy at large are translated through changes in the total demand for goods and services. The sequence of events leading up to changes in aggregate demand are known collectively as the 'transmission mechanism' of monetary policy. This series of events can be loosely grouped under two headings: (1) first-round transmission effects and (2) second-round transmission effects. First-round effects influence the economy primarily through INTEREST RATES. An easing of monetary policy, for instance, increases bank reserve availability,

transnational actors

which puts downward pressure on short-term interest rates. Longer-term rates fall, in turn, as people revise expected future short-term interest rates downwards. If inflationary expectations respond sluggishly, spending in interest-sensitive sectors (such as housing, consumer durables and business investment) picks up. This increase in spending stimulates aggregate demand, thus increasing both employment and output.

The second-round effect comes into play at this point. Because both employment and output increase, incomes also rise. This further stimulates consumption and investment spending. Moreover, the decline in interest rates positively affects asset values and the corresponding increase in wealth encourages even more spending.

The first-round effect is concerned primarily with interest-rate-induced changes in the flow of spending. The first-round effect is highlighted by the Keynesian view of the transmission process, while the second-round effect is afforded little importance. The second-round effect, on the other hand, focuses on policy events that alter the stocks of assets. The monetarist or quantity-theoretic view attributes primary importance to this second-round effect, while little credence is attached to the first-round effect. The monetarist view of the transmission mechanism stresses a more direct linkage than does the Keynesian view. That is, according to the monetarist view, agents dispose of money holdings in excess of some desired amount by paying out larger amounts for goods and services following an increase in the money supply. Thus the monetarist view holds that an increase in the money supply is associated with higher output.

Recent developments, however, have cast some doubt on both first-round and second-round policy effects. Since the mid-1970s, structural, institutional and regulatory changes have weakened the links connecting monetary policy and the economy. In addition, the move towards fully integrated world financial markets may have altered the manner in which monetary authorities are able to carry out independent policy actions.

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ROBERT LOONEY

transnational actors

The proliferation of transnational actors after World War II and their impact on international political and economic relations was first identified during the 1960s and early 1970s. Distinguished scholars, such as Raymond Vernon, Samuel Huntington, and ROBERT KEOHANE and Joseph Nye, introduced the subject and examined its meaning and significance. The subsequent expansion of transnational activity has sparked a spirited debate and the concomitant development of theoretical models that seek to explain their causes and effects. In the paragraphs that follow, we will analyse the organizational characteristics of transnational actors and the role performed by them in international politics. Competing approaches will also be presented for evaluation.

By way of an introduction, let us consider the following. What would happen to international monetary relations if the top fifty global banks were to collapse? What impact would an oil embargo by the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) have on the economies of the advanced industrialized nations? What would be the net effect on the world economy if the top transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) were to be plagued with a series of recessionary cycles? Pondering over such issues would compel any observer to conclude that these entities have a central place in the web of world relations. Transnational

actors that have existed in the past include the EAST INDIA COMPANY, the Catholic Church, joint stock enterprises and so forth. However, as Raymond Vernon has observed, prior to World War II, scholars rarely used terms like transnational corporations (TNCs), multinational enterprises (MNEs) or transnational actors. At the time, not only were theoretical approaches on the subject undeveloped, but even a passing reference to their existence was difficult to find. In the aftermath of the war, a transformation was observed in international affairs: the rise of transnational units. What distinguishes them from their predecessors is the level of integration of contemporary transnational actors and the truly global nature of their operations. Their growth was largely a by-product of the expansion of US power (see HEGEMONY, US). The initial catalyst for the development of organizations like the UNITED NATIONS (UN), WORLD BANK, the INTERNATIONAL MONETARY FUND (IMF), and numerous financial and commercial institutions, was the advancement of the interests of the United States. As such, the current level of transnationalism is a recent phenomenon.

How can transnational actors be distinguished from other organizations? For purposes of simplicity, we can identify four characteristics that all transnational entities share: (1) a highly coordinated and centrally organized bureaucracy; (2) the performance of specialized functions; (3) the performance of these functions across international boundaries, and (4) a high degree of integration among its global units (Huntington, 1973: 333). Even though they may be part of a particular NATION-STATE, their operations have a supranational quality. Generally, their affiliation is not to the state in which they reside, but to the objectives and functions of the unit itself. According to Vernon, they see the world as a chessboard with the individual squares representing nation-states (Vernon, 1998: 22). The form and scope of their activities separates them from other organizations.

The concept of transnational actors has its proponents, sceptics and opponents. Practitioners belonging to the three dominant para-

digms in international politics (LIBERALISM, REALISM and NEO-MARXISM) arrive at different conclusions. Liberalism can be subcategorized into two types: institutional and commercial. According to institutional liberalism, shared common interests among states create the conditions that give rise to transnational organizations. The collective interplay of self-interested states may lead to outcomes that are not socially optimal. Phrased more plainly, when states pursue policies to advance their own national interests, the social good of the whole unit may be unrealizable. Since transnational actors are predicated on joint decision-making, they promote cooperation between states on particular ISSUE AREAS and provide a forum for the resolution of disputes. These goods (referred to as PUBLIC GOODS) are provided by nation-states in their domestic societies. However, the absence of an overarching central authority in international politics precludes, or severely complicates, the acquisition of such outcomes. Hence, transnational organizations perform the same function in world politics as states perform in domestic politics. On the other hand, commercial liberalism sees the primacy of transnational corporations (TNCs) governing economic activity across national boundaries. They are viewed as the main carriers of knowledge, managerial skills and technology. In this conceptualization, transnational actors are largely responsible for production and wealth creation in the international political economy.

Those who espouse the realist world-view broach the issue from a different perspective. They contend that a state's foreign economic policy should not be determined by the external international environment. They envisage a world of sovereign states whose primary objectives are self-preservation and the pursuit of national interests. Here, states are the dominant actors without any sovereign above them. All other units, including transnational actors, are considered secondary in effecting behaviour and change in the international system. Since a central authority does not exist, states must make independent decisions based on power calculations relative

transnational capitalist class (TCC)

to their opponents. The policy recommendation, according to realists, is that states should not defer their SOVEREIGNTY to external agents like transnational actors.

The third approach, neo-Marxism, also opposes the role of transnational organizations, but for different reasons. From this perspective, transnational actors are the organizational embodiment of international capitalists, whose goal is capital accumulation at the expense of unprivileged classes. Their claim is that these entities are controlled by powerful elites in advanced industrialized countries, who wage a campaign of EXPLOITATION of underdeveloped societies. Aside from distorting developmental patterns, transnational actors are seen as responsible for undermining the national autonomy of LESS-DEVELOPED COUNTRIES (LDCs).

To conclude, neo-Marxists submit that transnational actors perpetuate powerful interests; liberals argue that transnational actors create a convergence of interests; realists declare that transnational actors should not be permitted to determine national interests. Irrespective of IDEOLOGY, the reality is that transnational actors hold a significant place in world politics. Such organizations, along with nation-states, are the main agents that comprise the international political economy.

See also:

actors

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ALI M. NIZAMUDDIN

transnational capitalist class (TCC)

Though the idea of an international bourgeoisie has been part of Marxist and neo-Marxist theory for some time (see MARXIAN ECONOMICS; NEO-MARXISM), the specific concept of the transnational capitalist class (TCC) is of more recent origin. While the international bourgeoisie tends to be conceptualized in state-centrist terms and to focus mainly on business leaders, the TCC is global in scope and includes groups that directly serve the interests of global capitalism. The concept is anticipated by several authors, notably in Robert Cox's thesis on the emergence of a global class structure and in the work of Stephen Gill on the Trilateral Commission, where he identifies a 'developing transnational capitalist class fraction'.

The concept plays a central role in Sklair's (2001) theory of the capitalist global system, where the TCC is the characteristic institutional form of political transnational practices in the global capitalist system (paralleling the role of transnational corporations (TNCs) in the economic sphere – see MULTINATIONAL CORPORATIONS (MNCs) – and consumerism in the culture-ideology sphere). In this formulation, the TCC is analytically divided into four main fractions:

- 1 TNC executives and their local affiliates,
- 2 globalizing bureaucrats,
- 3 capitalist-inspired politicians and professionals, and
- 4 consumerist elites (merchants and media).

The TCC is transnational in at least three senses: (1) its members tend to have outward-oriented global rather than inward-oriented national perspectives on a variety of issues – for

example, support for 'FREE TRADE' and neo-liberal economic and social policies (see NEO-LIBERALISM); (2) they tend to be people from many countries, more and more of whom begin to consider themselves 'citizens of the world' as well as of their places of birth, and (3) they tend to share similar lifestyles, particularly patterns of higher education (international business schools) and consumption of luxury goods and services. Despite real geographical and sectoral conflicts, the whole of the TCC shares a fundamental interest in the continued accumulation of private profit.

While most theory and research on class continues to be state-centrist, focusing largely on classes within specific countries, the growing influence of GLOBALIZATION in the social sciences appears to be encouraging more scholars to work in the global as well as the local context. In such an environment, increased interest in concepts like the TCC is to be expected.

See also:

capital

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LESLIE SKLAIR

TRANSNATIONAL CORPORATIONS (TNCS) see multinational corporations (MNCs)

transnational society

Transnational society encompasses social and political interactions that transcend state boundaries. While states themselves can be actors in transnational society, the concept

generally stresses non-state actors such as NON-GOVERNMENTAL ORGANIZATIONS (NGOs) and citizen activists. The politicized aspects of this transnational CIVIL SOCIETY arise in response to shared problems or concerns – relating, for example, to human rights, indigenous peoples or the EXPLOITATION of children. Transnational society is especially prominent in environmental affairs, where national and transnational environmental groups constitute a web of political relationships, sometimes confronting and sometimes working with states and other powerful actors. Some see here the possibility for conceptualizing and actualizing transitional democracy, emphasizing models of democracy that feature widespread access to political deliberation as opposed to aggregation of interest or contest for political power. Such developments can constitute a counterweight to the power of economic actors and imperatives in the international system.

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JOHN DRYZEK

transnationally integrated production

Firms are increasingly able to locate their activities across borders in such a way as to minimize production and other costs. This typically involves undertaking low-level manufacturing activities (of, for example, apparel, semiconductors, television sets) in countries with abundant cheap labour. Firms can either

transport costs

purchase these goods from independent manufacturers or, more frequently, internalize the activity by establishing manufacturing facilities overseas. Internalization is more likely, because the proprietary knowledge and labour skills that the firm requires are not available initially and must be developed. Firms coordinate their activities around the countries of the world in which they are active and, in some ways, can reduce the influence of government control as a result.

This form of production is increasingly important in the world economy and has major implications for the type and number of jobs available, not only in countries to which production activities are being switched, but also in those from which activities are removed. Although retaining low-grade manufacturing jobs within the domestic economy may not appear important if higher skilled or value-adding jobs are available, there are problems attached to loss of capacity and of opportunities for improvements in production and managerial technologies. In the United States, much concern has been expressed about the possible loss of jobs and the role of migrant workers whose willingness to accept lower wages has led to the relocation of industry. The role of government is to prepare the workforce for structural change by promoting skills and knowledge for new generations of industry.

The value of transnationally integrated production has recently been estimated as approximately US\$800 billion in the trade of manufactures, which represents some 30 per cent of the total trade of such goods (Yeats, 1998). Both value and proportion are likely to increase in the future, as multilateral organizations such as the WORLD TRADE ORGANIZATION (WTO) exert greater control over trade and investment activities, and as the ability of individual governments to regulate the activities of overseas firms therefore diminishes.

See also:

internationalization; trade, inter-industry and intra-industry

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JOHN WALSH

transport costs

The costs of moving goods, people and information are made up of two main components: fixed and variable costs. The fixed costs relate to provision of the transport mode and are spread across all journeys/movements, whereas the variable costs relate only to the particular movement itself. The ratio of fixed to variable costs varies according to what is being moved and how: for the movement of information via satellite, for example, the fixed costs of putting the satellite in place are extremely high but those of sending an individual message are very small; for a commercial traveller using their own car to visit customers, on the other hand, the fixed costs of the car are low relevant to the mileage undertaken in it and the variable costs – petrol, oil, tyres and so on – are relatively large.

Variable costs are usually proportional to either or both the length of the journey and the time that it takes: with a motor vehicle, for example, petrol consumption is proportional to the number of miles covered, whereas the cost of employing the driver is proportional to the time that the journey takes. Because the fixed costs (provision of the infrastructure, cost of loading the vehicle and so on) are constant however long the journey, total costs tend to taper off with distance: the longer the journey the lower the marginal cost of an additional mile. Most transport costs are not computed as continuous functions, however, but instead are organized zonally (as, for example, with the

costs of postage), with the outer zones broader than the inner zones to take account of the greater importance of fixed costs to short journeys.

Transport costs are a key variable in the models of locational patterns developed by geographers and others interested in LOCATION THEORY. Spatial order is produced, according to these models, by people making location-decisions to minimize transport costs and thereby maximize locational efficiency: as transport costs are related to distance, this makes geography a 'discipline in distance'.

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RON JOHNSTON

TREATY ESTABLISHING THE EUROPEAN COMMUNITY (TEC) *see* Treaty of Rome

Treaty of Rome

Also known as the Treaty Establishing the European Community (TEC), the 1957 Treaty of Rome is in fact two treaties. The first, and most important, set up the EUROPEAN ECONOMIC COMMUNITY (EEC). The second established the European Atomic Energy Community.

In 1954, the attempt to establish a European Defence Community had failed, as it was considered to demand too great a sacrifice of national SOVEREIGNTY. Given the need to continue peaceful restructuring and growth in the member-states of the then EUROPEAN COAL AND STEEL COMMUNITY (ECSC), the Rome treaties nonetheless ensured that Eur-

opean integration would continue, but gave it a primarily economic method. The TEC does, however, commit its signatories to a process of 'ever closer union', an ambiguous phrase whose meaning remains unclear. Periodically revised, the TEC remains the central plank of European INTEGRATION.

See also:

Maastricht Treaty

ALEX WARLEIGH

Triad

The term 'Triad' is used to describe the emergence of three distinct centres of economic activity in the global economy: North America, Europe and East Asia. These centres comprise the leading industrial regions and countries of the world and increasingly set international trade policy, generate consumer and industrial trends, and provide much of the capital and expertise for the rest of the world. It is estimated, for example, that the Triad is responsible for well over half of the world's trade and nearly 80 per cent of global FOREIGN DIRECT INVESTMENT (FDI) flows. In terms of individual corporations, of *Fortune* magazine's leading 500 companies in 1991, 169 were European, 164 North American and 110 Japanese.

Concomitant with the distinct regionalization of economic activity are varying degrees of regional INTEGRATION within the Triad. Obviously this is most developed in Europe, where fifteen nation-states are members of the EUROPEAN UNION (EU) which, in addition to a form of supranational governance in the EUROPEAN COMMISSION, adopted its own single currency – see EUROPEAN CURRENCY UNIT (ECU). In 1992, the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) came into force between the United States, Canada and Mexico. While other states such as Chile have applied to join NAFTA, the United States has promoted the eventual creation of a free trade

area that would encompass all the nations of the Western hemisphere: the so-called Free Trade Area of the Americas (FTAA). In East Asia the picture is more complex, with no comparable corresponding institution to either the EU or NAFTA. While the ASIA-PACIFIC ECONOMIC COOPERATION FORUM (APEC) exists, this is not region-specific (comprising, for example, all three NAFTA countries). The ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN) has a geographically limited membership, while the much vaunted EAST ASIAN ECONOMIC CAUCUS (EAEC), promoted by Prime Minister Mahathir Mohammad of Malaysia, has made little progress. Nonetheless, Japan has fostered interdependencies and friendly links in Asia through trade, direct investment and foreign aid.

Finally, within each region of the Triad, financial transactions are dominated by an actual or *de facto* single currency. In the Asia-Pacific region, despite the lack of formal integration, the Japanese yen dominates financial transactions to such an extent that many commentators suggest that we are seeing the emergence of a yen bloc. Among the countries of NAFTA and the Western hemisphere, the US dollar is pre-eminent (see DOLLAR, US), while eleven of the fifteen member-states of the EU proceeded with the launch of a single European currency, the euro, on 1 January 1999. Although the euro faltered in the first few months of its existence, the economic weight of the EU in terms of output and world trade make it almost inevitable that the euro will challenge the international role of the dollar. Whether the euro achieves parity with the dollar or not, international finance will (like output and trade) become increasingly Triadic in nature.

What is evident in the literature on the Triad is that there is a noticeable distinction between those who regard the emergence of the Triad as being incompatible with GLOBALIZATION and those that see it as complementing it. For the former group, national economic competition and accompanying national industrial policies are increasingly being superseded by regional competition and strategies to ensure competi-

tiveness at a region-wide level. By contrast, the latter stress that while regional patterns of economic activity can be discerned, such patterns are part of a more diverse and complex globalized economy in which all the major centres of economic activity are fundamentally interlinked and therefore interdependent. Furthermore, the recent growth of regional economic arrangements have taken place in a climate of increasing trade LIBERALIZATION. Consequently, the emergence of the Triad is not incompatible with global FREE TRADE.

Among the latter group (and arguably one of the first to use the term 'Triad') was the managing director of McKinsey and Company, Kenichi Ohmae. In his book *Triad Power* (1985), Ohmae argued that – given the realities of the international economy – multinationals needed to establish themselves in each part of the Triad, become 'insiders', in order to compete effectively in the global economy. According to Ohmae, competition is shifting away from firms of one nation battling in the marketplace against champions of another. Instead, one international consortium of companies will compete with another that similarly crosses international boundaries. Competition in automobiles, for instance, is not just GM, Ford and Chrysler from the United States against Toyota, Nissan, Honda and Mazda from Japan or Volkswagen, Mercedes and BMW from Germany. It is also the international consortium of GM, Opel, Saab, Isuzu and Suzuki competing with that of Ford, Mazda, Jaguar and Aston Martin.

Similarly, while the world economy may have become regionalized, the TRADE BLOCS of today are very different from those of the 1930s. Average TARIFF levels among the industrialized countries have fallen sharply since the end of World War II, from approximately 40 per cent to between 2 and 4 per cent today. Consequently, regional economic blocs are not exclusive trading entities and fears of trade wars between them are largely misplaced.

Since the first wave of post-war economic integration in the 1950s and 1960s, one of the principal debates over REGIONALISM has con-

cerned whether the formation of a trade bloc would lead to trade creation or trade diversion (see **TRADE CREATION AND TRADE DIVERSION**). Obviously, if integration leads to the former then it will be complementary to multilateral free trade. Most economists accept that where economic groupings (1) are geographically proximate and (2) already trade intensely with each other, trade-creating effects will almost certainly outweigh trade-diverting effects. For example, the expansion of the Canada-United States Trade Agreement (CUSTA) to Mexico (creating NAFTA) had few trade-diverting effects since, even before the conclusion of the agreement, approximately 80 per cent of Mexico's exports went to the United States. Indeed, when the URUGUAY ROUND of trade negotiations faltered during 1991-2, many observers saw regionalism as the fastest road to multilateral free trade, since proximate countries would be capable of concluding trade liberalization more successfully than the 154 members of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) (World Bank, 1992).

Other commentators, however, do not share Ohmae's optimism. Instead, they regard the growing regionalization of the world economy as representing a trend away from free trade towards growing protectionism and eventual closure. While free trade zones were consistent with the rules of GATT, critics claim that many aspects of such arrangements violate the principle of non-discrimination. Furthermore, the growth of intra-regional trade threatens to result in the emergence of competitive mercantilist trade blocs (see **MERCANTILISM**). By 1998, for example, exports within the EU accounted for over 60 per cent of the region's trade. In fact, only in North America is extra-regional trade more significant than trade within the bloc.

Mercantilist sentiments were evident in the debate over NAFTA and the creation of the European single market, and are a feature of **STRATEGIC TRADE THEORY**. According to this logic, region-wide economic and trade policies develop as a response to competitive pressures. Such policies may include common negotiating

policies at international economic institutions, such as the **WORLD TRADE ORGANIZATION (WTO)**, or common high-technology or other industrial policies. However, they can also include openly protectionist and discriminatory arrangements. For example, EU trade with Japan has been subjected to a plethora of **VOLUNTARY EXPORT RESTRAINTS (VERs)** in items ranging from automobiles to VCRs and quartz watches. By 1989, approximately 40 per cent of Japanese exports to Europe were subject to such protectionist controls. The fear is that such controls could increase trade friction between the constituents of the Triad. This may lead to trade wars between the major economic regions and, with them, to a breakdown of the liberal international economic order.

Regardless of whether or not the formation of trade blocs adversely affects global free trade, those outside the Triad may have cause for concern. In nearly all international economic institutions today, the countries of the Triad not only dominate proceedings, but also effectively provide their leadership. Nowhere is this more evident than in the annual economic summit meetings of the **GROUP OF 7 (G-7)**, now **G-8**. Similarly, in organizations like the **WTO**, the impact of regional blocs is clear, since the EU has much greater bargaining power than its member-states would have individually. Consequently, in a world dominated by the Triad, those outside fear either the diminution of their bargaining power or, worse still, exclusion.

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trickle-down

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JASON P. ABBOTT

trickle-down

'Trickle-down', as its name suggests, is not a precise scientific term. It has also been carelessly applied by politicians and commentators to convey different meanings to different groups. Used literally in an economic context, 'trickle-down' describes a process whereby wealth or economic activity spreads down from above.

In Keynesian terms (see KEYNESIAN ECONOMICS), the 'above' might be government-expenditure-induced growth that, through the multiplier, diffuses demand- and income-generating capacity throughout the economy. In supply-side terms, the trickle-down of income and activity is usually said to stem from increases in private sector investment and wealth creation induced by tax cuts. Trickle-down is now widely taken to mean the hypothesis that allowing the richest to maximize their wealth is the most effective means of raising the income of the poorest, as opposed to any income redistribution policy.

To advocates and detractors, four main issues surround trickle-down:

- 1 To what extent does the market facilitate trickle-down (that is, how big is the trickle)?
- 2 Does everyone participate in the trickle-down (that is, do we get sufficient trickle-down to alleviate poverty)?
- 3 Is trickle down fair (that is, what are the impacts on the distribution of income)?
- 4 Does the source of the trickle matter (that is,

are the outcomes of 1–3 above affected by whether growth is led by the government or the private sector)?

The answers to 1–4, and the priorities attached to poverty and income distributional questions, usually determines a commentator's opinion concerning the role of the state and the appropriate scope for public policy.

Today's supply-siders (see SUPPLY-SIDE ECONOMICS), partly echoing the classical economists, favour a minimal role for the public sector – limited to the provision of essential public works, the maintenance of law and order, and the defence of the country. In their view, the government should guarantee property rights and the sanctity of contracts, and should protect the economic and political liberties of individuals. These can be considered as the core activities of the public sector.

Modern-day supply-siders argue that, if private investors are endowed with more capital – often through tax reductions – *ceteris paribus* they, by acting alone, will invest (all) these monies to stimulate the economy, create jobs and, through the trickle-down process, raise living standards. A concern for eliminating poverty is separated from any moral concern over levels of inequality. Certain individuals or groups might not participate in the trickle-down, but supply-siders typically argue that this is not sufficient to justify alternative policies and that intervention (by reducing the incentives for entrepreneurship) would lead to lower overall activity and welfare in the economy. This theory has profound implications, especially that specific programmes to benefit the poor need not be enacted.

Marxist and socialist thinking argues that inequality and poverty are necessary outcomes of unchecked markets (see MARXISM–LENINISM; SOCIALISM), with state intervention being necessary to ensure general prosperity (see SUBSISTENCE WAGES).

Keynesian thinking is more eclectic. Many Keynesian economists now conclude that market forces and government expenditure are not in-and-of-themselves sufficient to

sustain expanded income gains through the trickle-down process. Instead, various forms of public assistance to those whose income falls below certain levels are necessary. These ideas can be seen in the mid-1960s 'war on poverty' in the United States. Rather than assuming that poverty would automatically be eliminated through economic growth, some Keynesians argued that the groups of contemporary poor remained largely untouched by growth; some went so far as to argue that this 'hardcore' group forms a 'permanent underclass', completely out of the trickle-down process. This phenomenon has become known as the 'backwash thesis' (see BACKWASH EFFECTS). Similar ideas can also be seen in the World Bank's 1970s concept of 'redistribution with growth' (Chenery *et al.*, 1974), which aimed to ensure (through government action) that the nature of the growth process benefited all groups in developing economies.

Recent research has found evidence of a negative association between inequality and economic growth (Persson and Tabellini, 1994). The robustness of this association and the reasons for it are debated, but may reflect harmful social conflict in unequal societies.

See also:

distribution of income; 'Reaganomics'

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ROBERT LOONEY

Triffin dilemma

The Triffin dilemma arose out of the workings of the international financial system established in the BRETTON WOODS SYSTEM (1944–73). Bretton Woods differed from the GOLD STANDARD in one essential respect: the use of FOREIGN EXCHANGE along with gold as international reserves. This turned out to be its fatal flaw.

The core of the Bretton Woods system was the definition of the members' currencies at a fixed parity with respect to the US dollar (the dollar being defined as \$35 per ounce of gold) and the commitment by the United States to redeem the dollars held by foreign central banks with gold (see DOLLAR, US).

Early on, it became apparent that the system was not capable of providing the optimal amount of liquidity to finance the growth in world trade. The liquidity problem, posed by Robert Triffin (1961), evolved from a shortfall of monetary gold beginning in the late 1950s. As Triffin warned, dollars supplied by the US deficit could not be a permanent solution to the impending gold shortage because, with continuous deficits, US monetary gold reserves would decline both absolutely and relatively to outstanding dollar liabilities until an eventual convertibility crisis was reached. Should the US monetary authorities close the deficit before such a crisis, however, it would create a massive shortage of international liquidity and the prospect of world deflation.

As it turned out, steady expansion of dollar reserves in the 1960s contributed to rising prices and rising prices steadily diminished the

trilateralism

supply of new gold. However, as Triffin anticipated, the more dollars the United States supplied to the world to meet its need for liquidity, the more doubtful it became that the United States could maintain the convertibility of the dollar into gold at the existing price and the more reluctant other countries became to hold dollars. This was the Triffin dilemma. Triffin's prediction was that the system would eventually face a run on the dollar, which would lead either to price deflation or to the suspension of gold convertibility. The run began in 1968 and gold payments to the private sector were suspended.

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ROBERT LOONEY

trilateralism

'Trilateralism' refers to transnational collaboration among elite individuals in North America, Europe and Japan, manifested in the Trilateral Commission (TC) – a non-governmental body nominally made up of private individuals.

The TC was formed in 1973 by high-level individuals who wanted to influence international relations between Europe, North America and Japan. The TC had 335 members as of 1999, with three chairmen representing each of the three regions. Many of its members have served at the highest levels of government; many of its members leave to take up posts in government. This was especially true in the United States with the advent of President Jimmy Carter. Almost all the senior positions in the Carter administration were drawn from the TC, including a former director of the TC (national security advisor Zbigniew Brzezinski). President George Bush was a member of the TC, as was his Secretary of Defense, Caspar Weinberger. Paul Volcker, former chairman of the US Federal Reserve System, then

served as the TC's North American Chairman. Prominent politicians from other parts of the world have also been involved in the TC. For example, former Japanese Prime Minister Kiichi Miyazawa has been active in the TC since its founding and another member, Shijuro Ogata, was once Japanese ambassador to the United States. One chairman of the TC's European group was Otto Lambsdorff, former president of Liberal International. Other members have been drawn from INTERNATIONAL ORGANIZATIONS (IOs), private industry, banks, the media and sometimes academia.

In particular, founders of the TC believed that the leadership position that the United States enjoyed in the years following World War II was being eroded and that shared leadership with Japan and Europe would be necessary if all three regions were to prosper. As such, one of the TC's goals has been to promote and understand the impact of European unification. Indeed, many members of the TC were active in the formation and expansion of a unified Europe. The agendas of the TC's annual meetings vary, but the organization tends to be most concerned with international economics and particularly with the promotion of FREE TRADE in goods, capital and intellectual property. Its influence is at the policy level within countries of the three regions, reflecting the nature of its membership.

See also:

Triad

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PAUL G. HARRIS

Tripartite Pact

The Tripartite Pact of 1936, which involved the British, French and US treasuries and followed the French abandonment of the GOLD STANDARD, is often regarded as a 'milestone' in moving away from the floating and depreciating currencies of the GREAT DEPRESSION and back to a system of FIXED EXCHANGE RATES. It is thus seen as a kind of predecessor of the BRETTON WOODS SYSTEM. The accompanying Declaration stated that 'the constant object of policy is to maintain equilibrium in international exchange and to avoid utmost disturbance there by monetary action'.

In fact, the actual achievement was so modest as to be in practice non-existent. The only commitment to fixing exchange rates was for a twenty-four-hour stabilization and the rates of September 1936 between the dollar, the franc and the pound did not hold. Within months France sank back into currency turmoil and renewed devaluation. There were some technical facilities in the past that assisted action in the exchange markets: the United States would sell gold for dollars. But US Treasury Secretary Henry Morgenthau did not get the controls on capital movements that he desired.

The most significant aspect of the pact is perhaps a negative one: it was made between

treasuries and their stabilization funds, rather than between central banks. In this way, it marked the complete destruction of the system of international central bank cooperation that had developed in the 1920s. As in Bretton Woods, finance ministers and treasuries now played the leading role in moulding international agreements.

In general, the pact had a political significance that was greater than its financial or economic content: it was supposed to mark an alliance of democracies against the threat of FASCISM and Nazism, and it was interpreted in this way especially by Morgenthau and by the French Popular Front government of Léon Blum. But as a defence of democracies and their economies, it was remarkably slight. Like many subsequent agreements (including the PLAZA and LOUVRE ACCORDS), it is more important in currency mythology than in financial history.

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HAROLD JAMES

Trotskyism

The term 'Trotskyism' has been used alternatively as a term of political abuse, a neutral characterization of an intellectual current within twentieth-century Marxism and a simple shorthand way of describing the organized followers of Leon Trotsky – the Russian revolutionary who was exiled from the USSR in 1929 and assassinated eleven years later by a Soviet agent. Significantly, Trotsky never liked the term – and for good historical reason: it was an invention of his enemies who, in the

party disputes of the 1920s, sought to draw a sharp ideological distinction between an emerging orthodoxy defined as 'Leninism' (see MARXISM–LENINISM) and a presumed heresy known as 'Trotskyism'. Yet once invented, the term could not be disinvented, and it soon became part of modern political discourse. Whether or not Trotsky himself should be held responsible for what was subsequently said and done in his name is open to discussion. Trotsky, after all, was no stranger to political polemic. Nor was he loathe to denigrate those who, in his view, had abandoned the revolutionary faith. Nonetheless, he was an immense intellectual presence and one suspects that his reputation has suffered as much from the activities of his erstwhile followers as it has from the crude attempts by his opponents to diminish and distort his historical role.

At the highest level of theoretical abstraction, Trotskyism derives its intellectual inspiration from two ideas closely associated with Trotsky's name: (1) the law of uneven and combined development and (2) PERMANENT REVOLUTION. The first drew Trotsky to the highly revisionist conclusion (in 1904) that a socialist revolution was more likely to take place in backward Russia than in the more advanced capitalist states of Western Europe. The second led him to argue that once it had assumed power, the new revolutionary regime would have no choice but to push forward and carry the banner of revolution beyond Russia's frontiers. Otherwise the victorious workers of Russia would either be crushed by the social weight of the Russian peasantry, or by the sheer economic power of international capital. Either way, there was no possibility of building genuine SOCIALISM in an underdeveloped country situated in a sea of world CAPITALISM.

Trotsky's daring thesis inevitably drew him into conflict with more orthodox Marxists, who before 1917 assumed that it was impossible for Russia to jump to the head of the revolutionary queue. Once it did of course, Trotsky's heterodox views were quietly forgotten – only to be dusted down and brought out of the political closet by those who now advanced the even more heterodox argument

that not only was SOCIALISM IN ONE COUNTRY possible, but world revolution a dangerous political fantasy. In the bitter disputes which followed, Trotsky found himself increasingly isolated by the party machine under Stalin's control and he was finally expelled from the organization in 1927. Trotsky, however, did not lose faith and insisted that the party could still be reformed from within. A single development was to change his mind: the coming to power of Hitler and what Trotsky regarded as its inevitable consequence – another world war. This extreme situation demanded extreme measures, he believed, and he set about constructing a new party and a new 'Fourth' International in the hope that something could be salvaged from the wreckage. He also felt, indeed predicted, that World War II (very much like World War I) would create new revolutionary possibilities in the West. He seemed certain too that the Soviet regime could not survive the shock of the war and would emerge at the end politically transformed.

Trotsky's anticipation of revolutionary change was not borne out by events. Capitalism persisted, albeit bruised and reformed, while Soviet COMMUNISM not only endured, but even managed to reproduce itself in different forms in Eastern Europe and China. This posed immense problems for Trotsky's followers, who had not entertained the possibility of either capitalism surviving or STALINISM spreading. As a result, some simply threw in the political towel. A few even joined the communist or SOCIAL DEMOCRATIC PARTIES in the hope they might be pushed to the left. Most, however, decided to soldier on alone. But the prospects were decidedly dim. Trotsky himself was dead. The movement to which he gave birth in 1938 was deeply divided in its analysis of the USSR. The West stood on the cusp of a long boom led by the United States. The world was about to plunge into prolonged COLD WAR. And in the so-called socialist countries, repression and isolation combined to prevent revolutionary change.

Under such circumstances it was perhaps inevitable that those claiming the mantle of

Trotskyism should split and divide. Hemmed in on one side by a powerful SOCIAL DEMOCRACY and a well-financed communist movement, and on the other by a dynamic capitalism, Trotskyism failed to flourish – except in a few of THIRD WORLD countries like Bolivia and Ceylon (now Sri Lanka). Elsewhere it was barely noticeable, though it did recruit more than its fair share of intellectuals – the most influential perhaps being the Belgian Marxist ERNEST MANDEL. Trotskyism, however, did manage to take advantage of the occasional political crisis which upset the post-war status quo. Thus it recruited a number of disillusioned communists following the Soviet invasion of Hungary in 1956. It then played a not insignificant role in the ‘events’ of 1968 and, for a while, established a real presence in France and the United Kingdom. Yet the movement never quite broke out of its ghetto and remained for many an irrelevant political sideshow whose militants resembled political monks in a self-enclosed church more than a serious challenge to the established order.

Trotskyism was the product of defeat and never quite managed to throw off that scent. Nonetheless, during its long and very intense history – especially intense for those who happened to join one of its several warring factions – it did happen to attract some of the best and brightest of a generation who refused to accept that there were only two choices open to humanity: Western-style capitalism or Soviet-style socialism. This refusal may have rendered them politically marginal, but at least from the margins they could analyse the world with a degree of critical insight denied those who either defended the USSR or could see no alternative to the market. It remains to be seen whether they will continue to do so now that the Soviet Union has fallen apart and all future history – or so we have been told – is the history of liberal capitalism.

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MICHAEL COX

trust

Definition

Where an agent A has some discretion in how to act, a principal P trusts A if and only if

- 1 P has some beliefs (reasons for trust) about A based on:
 - (a) prior experience of A;
 - (b) A's reputation;
 - (c) some shared characteristic of identity between P and A; and/or
 - (d) some institutional fact (legal obligation, specific guarantee or other ‘hostage’ given by A);

trust

2 these beliefs lead to P's expecting that A's behaviour under discretion (tasks for trust) will be in accordance with:

- (a) A's stated intentions (prudential trust);
- (b) any specific contact or legal duty to an implied standard of competence (contractual trust); or
- (c) A going beyond or even setting aside the contract in order to act in P's real interest (goodwill trust); and

3 P *relies* on A, by putting some of their own interests at stake in the relationship.

(This definition draws on 6, 1994; Zucker, 1986; Sako, 1992; Barber, 1983.)

P and A may be individuals, organizations, groups or states.

Causes

In classical political economy, it was not imagined that there would be any special problem of achieving sufficient trust between people to enable them to engage in commercial transactions or governance. For SMITH, Hume and Ferguson, there was a general problem of institutionalizing human sympathy and harmonizing the pacific interests over the more dangerous passions into a CIVIL SOCIETY. While Scottish enlightenment thinkers differed on how this was to be done, they shared a common optimism that, at least in a civil society, reason would provide people with sufficient motivation to trust one another. Much of contemporary economics and PUBLIC CHOICE (PC) THEORY in politics (Bianco, 1994) have, without making much of the philosophical assumptions, worked with a similar view. (On the place in modern thought of enlightenment optimism about reason sufficing for trust, see Hollis, 1998.) For example, contemporary game theorists (see GAME THEORY) have identified strategies of reputation-building for players in indefinitely repeated PRISONERS' DILEMMA games, which will lead (on average and over the long run) to more transactions based on trust than those based on betrayal. Essentially, one builds a reputation for one's

own trustworthiness and for punishing the defections of others (Axelrod, 1984). There is some evidence that goodwill trust, where it is achieved, is more likely to be associated with experience and reputation-based reasons (6, 1998).

In less optimistic periods, political economists have taken very different views. HOBBS famously considered that reliance on the reason of individuals would not suffice and that some form of regulation would be necessary to induce people to behave in a trustworthy manner. Anthropology and sociology are replete with studies of people whose trust goes no further than their immediate kin (Fukuyama, 1995), village, tribe, TRADE UNION (Fox, 1974), class, nation, cartel (see CARTELS), industry or other cultural group where COLLECTIVE ACTION problems have been solved (Olson, 1971), and where no amount of enlightened self-interest will persuade people to expand the scope of trust. (For a theory of cultural bias as a key determinant of trust decisions and collective-action capacities, see Thompson, Ellis and Wildavsky, 1990; also 6, 1998).

The heart of the difference between these two views turns on the power of reasons and tasks (see definition above). Enlightenment optimists believe that experience and reputation are the most powerful reasons for trust. Sociological pessimists tend to believe that norms (Gouldner, 1960; Elster, 1989) – shared characteristics of familiarity and identity – are the most powerful, but may be breaking down under contemporary conditions (Seligman, 1997), while political pessimists like Hobbes see institutional reasons as the most powerful. Enlightenment optimists believe that when goodwill trust is betrayed, what remains may well be at least prudential and perhaps even contractual trust, whereas pessimists tend to believe that on betrayal, even prudential trust is lost, and that conflict is typically provoked (for example, see Bies and Tripp, 1996). There are some optimists who argue the centrality of institutional reasons (Zucker, 1986) and some public choice theorists who assert the importance of shared identities (Dunleavy, 1988).

Consequences

The individual and social benefits of trust and the disadvantages of distrust are well known (Gambetta, 1988). In extreme cases, the destruction of trust can result in the wholesale destruction of a society. (It was originally John Locke who described trust as the *vinculum societatis* or bond that holds society together; see Turnbull, 1978; Dunn, 1990.) In the absence of trust, psychological security and development may be at risk (Marris, 1996), there is less trade, collective action becomes very difficult (Crouch, 1982), and networks and organizations of any size hard to create and sustain (Fukuyama, 1995), competitiveness may be lost (Lane and Bachmann, 1998). GOVERNANCE becomes less legitimate and more reliant on force (Dukes, 1996), and conflict within and between organizations and groups becomes more difficult to resolve. More generally, it has been argued recently that there are widespread EXTERNALITIES for governance that come from having a background of high levels of generalized social trust (Putnam with Leonardi and Nanetti, 1993; Fukuyama, 1997). Economists explain the possibility of gains from trust by arguing that trust reduces the costs of exchanging information (Pruitt and Carnevale, 1993) and of entering into, monitoring and enforcing agreements (Williamson, 1986; Arrow, 1974; Coase, 1937); sociologists tend to explain the benefits by pointing less to the impact of trust on the ability to transact than on willingness to transact, on the habitual and taken-for-granted character of transactions within a setting of trust (Garfinkel, 1984; Misztal, 1996; Bourdieu, 1977).

Enlightenment optimists and sociological or political pessimists also take different views of the costs of high-trust relations. Optimists tend to believe that individuals will typically only pay the costs of trust-building to the margin where the benefits outweigh them. Pessimists either suspect that the costs of high-trust relationships will be dumped on others through exclusivity and social closure (Ridley, 1996) or else that social closure in high-trust societies

may lead over the long run to introversion, gridlock (Olson, 1982) and deterioration.

Policy

Policy prescriptions for buttressing or enhancing trust also differ according to the policy-maker's fundamental outlook on political economy. Those pessimists who diagnose insufficient trust, prescribe institutional buttressing for long-term behaviour – for example, providing incentives for long-term investment, bolstering contract-law obligations and providing institutional support for consensus between groups, perhaps even to the point of neo-corporatist bargaining arrangements (Hutton, 1995; Dore, 1997) or reinforcing family duty (Fukuyama, 1997); these pessimists tend to regard the costs of gridlock, loss of freedom of choice about relationships and introversion as worth paying. Optimists, by contrast, tend to regard at least some kinds of institutional regulation as more likely to destroy trust than to create it and call for its removal, believing that reform should concentrate on freeing markets in information to support better judgements of experience and reputation in order that trust decisions can be more soundly based. So, for example, those who are optimistic about international relations welcome the shift since the last years of the COLD WAR to mutually agreed and fostered surveillance in military affairs as a more effective strategy for trust-building than traditional mutual deterrence (Cooper, 1996).

The future of the trust debate

Debates about how to buttress reasons for trust and how to enable higher levels of task for trust to be achieved are increasingly central in contemporary political economy. There is probably no general answer as to whether enlightenment optimists or sociological and political pessimists are correct about the likelihood of trust-building on the basis of unfettered experience and reputation. Most likely, different kinds of reasons are important in different settings and contexts, and where

different histories have locked in particular behaviours and assumptions. The most useful contributions to look for in the next phase of the debate will be those that can develop effective classifications of the types of conditions in which different trajectories of trust can be sustained.

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PERRI 6

R. ROTHCHILD

trusts

A 'trust' (as a cartel is known in the United States – see CARTELS) is a group of firms which bind themselves by explicit agreement to maintaining an agreed price or output. By acting in this manner, the parties secure for the group as a whole higher profits than would be obtainable under conditions of open competition. Such anti-competitive behaviour is held to reduce consumers' welfare because it often results in smaller output and/or higher market prices than would otherwise prevail. For this reason cartels are, with few exceptions, outlawed in most countries.

Cartels are more likely to be established when the participants produce similar products, when demand is relatively inelastic and when the number of firms involved is small. Even in these cases, however, cartels face a number of problems. The first is that differ-

ences in firm size can mean that relatively large (or low-cost) firms may dominate the cartel. The allocation of shares in cartel profits then becomes problematic. The second is that, although cartel formation increases collective profits, each member has an incentive to lower its price or increase its output provided that the others do not. Individual inclination toward such 'cheating' means that cartels tend to be unstable. The third problem is that the detection of cheating and the apportionment of appropriate 'punishment' are not straightforward matters.

Where punishment for cheating does occur, it may take the form of reversion by the cartel as a whole, for a period, to a price or a level of output closer to that which would emerge under open competition. Since this reduces the gains from cheating, the threat of such reversion is in itself one reason why firms may prefer to abide by the cartel agreement. Nevertheless, few cartels apart from those that enjoy legal status or the control of a scarce natural resource survive for very long.

turnkey projects and industries

'Turnkey projects and industries' refer to a form of international TECHNOLOGY TRANSFER in which entire production systems in a specific industry are sold to and constructed in the host country. The foreign firm constructs a production plant and related production-input facilities in their entirety, without local input; recipients simply 'turn the key' and the production machinery begins to operate. Turnkey projects, in contrast to more piecemeal forms of technology transfer – such as implanting new pieces of equipment in old production systems – are believed to enhance productivity in industries with high levels of local engineering expertise. They are particularly popular in the automotive and chemical industries: foreign investors often prefer them, because they ensure quality control. Some analysts criticize them as obstacles to indigenous

two-gap model

DEVELOPMENT, however, because they do not use local inputs and expertise in project design, construction or production.

BEVERLY CRAWFORD

two-gap model

The two-gap model demonstrates how foreign capital inflows raise the recipient's growth rate by supplementing either domestic savings to raise investment ('filling the savings gap') or export earnings to increase imports ('filling the trade gap' or 'foreign exchange gap'). A main purpose of gap models has been to calculate the AID inflow required to attain a particular growth rate, though the model also underlies much analysis of aid's macro-economic impact.

The two gaps of the two-gap model were used separately during the 1950s in exercises to estimate requirements for foreign inflows and were first combined by HOLLIS CHENERY and Michael Bruno for an analysis of Israel. More famously, Chenery and Strout (1966) applied the model to an aid-requirements exercise for USAID. A number of other papers followed in a similar vein, though a later review by the DEVELOPMENT ASSISTANCE COMMITTEE (DAC) concluded that these exercises had had little impact on either the level or allocation of aid. However, the Revised Minimum Standards Model (RMSM) of the WORLD BANK owes something to the two-gap model and is still used to forecast foreign-exchange requirements.

The two-gap model is based on the Harrod—Domar equation (see HARROD—DOMAR GROWTH MODEL), in which capital accumulation (the rate of investment) is the only determinant of growth (though Chenery and Strout allowed for an absorptive capacity constraint at low levels of development). Specifically, the Harrod—Domar equation can be written to give the investment required to attain a particular growth rate. If domestic savings are less than this amount, there is a savings gap, which may be filled by foreign savings (capital inflows). Investment requires

capital goods, most of which have to be imported, so that the level of imports necessary to sustain growth may be calculated. If export earnings are less than this amount, there is a trade gap. The binding constraint is the larger of the two gaps and foreign inflows must be sufficient to fill this larger gap if the desired growth rate is to be attained.

Recent work has added a third gap: the fiscal. Three-gap models assume a positive (crowding in) relationship between public and private investment. Hence, if public investment is constrained by a public spending limit, aggregate investment may fall short of that required to reach the target growth rate.

Critics point out that the model is excessively structuralist, as it contains no prices (the exchange rate and interest rate) that could move to eliminate the gaps. In practice, it is argued, there need be no gaps: these only exist if governments introduce distortionary policies which prevent markets from clearing. Possible replies to this criticism are that the model is adequate for short-run forecasts, that the exchange rate required to clear the market implies too low a standard of living or that adjusting the model to allow price effects will not alter the fact that additional inflows are required to raise the growth rate.

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HOWARD WHITE

two-power standard, British naval

Alarm in Britain in 1884 over the progress that the French navy were making in catching up with the British navy, led to a commitment to increased naval spending and building. The

basic idea was to maintain the British naval lead by equalling the combined strength in battleships and cruisers of the two main rivals in the 1880s (France and Russia), plus a small extra margin for good measure. This was the 'two-power standard'.

Even though the leading rivalry status of France and Russia eroded fairly quickly, the

standard survived as an institutionalized rule of thumb, but one which meant less and less in the context of more serious US and German naval expansion in the late nineteenth and early twentieth centuries.

WILLIAM R. THOMPSON

U

ultra-imperialism

The term 'ultra-imperialism' was coined by the German Marxist KARL KAUTSKY on the eve of World War I, to suggest that CAPITALISM could produce peace between the great powers, in order that they could cooperate in exploiting the rest of the world rather than fighting over it.

Kautsky argued that industrial advance required access to sizeable agricultural hinterlands, leading developed nations to seek control of LESS-DEVELOPED COUNTRIES (LDCs). But though this expansionism was a structural necessity, imperialist conflict between the great powers was not. Even during World War I, he said the war was a temporary clash reflecting special interests, not the long-term interests of the capitalist class as a whole. Just as economic competition gave way to monopoly agreements and CARTELS, so the costs of war (and the resistance of the masses at home and in the colonies) would force peace on the leading capitalist classes – who would form a 'political cartel' to collectively exploit the world.

A noteworthy feature of Kautsky's theory is its convergence with the dominant motif of liberal political economy (from ADAM SMITH to contemporary liberal theorists of INTERDEPENDENCE like ROBERT KEOHANE – who cites Kautsky's theory) in identifying capitalism with 'rationality' of means and outcomes. This implies that war, MERCANTILISM and IMPERIALISM are prohibitively costly and irrational from a capitalist point of view. Kautsky's combination of this argument with the theme of economic expansionism (and the attendant but avoidable dangers of inter-state conflict) is also similar to many liberal theories (from Smith's critique of mercantilism through late

Victorian critics of imperialism like NORMAN ANGELL and onwards).

However, Kautsky's concept also prefigured radical critics of capitalism, who do not posit universal benefits from the market but predatory exploitation. The modern inheritors of this aspect of 'ultra-imperialism' are post-World War II theorists of UNDERDEVELOPMENT and dependency. For, despite their use of the term 'imperialism' and their citing of LENIN, their vision of the rich 'core' nations cooperating to exploit the rest of the world is much closer to Kautsky than Lenin.

From the 1970s onwards, Western Marxists again discussed whether 'ultra-imperialism' had overtaken 'inter-imperialist' rivalries among the Western powers – this time in relation to the transnationalization of production, the rise of the EUROPEAN COMMUNITY (EC), its (potentially competitive) relations with the United States and the global role of the United States – in debates that foreshadowed contemporary discussions of GLOBALIZATION (see Brewer, 1980). With the collapse of STALINISM and of radical THIRD WORLD nationalism, the cooperative dominance of Western great powers seems stronger than ever, and the idea of ultra-imperialism (but not the term) is a popular radical rival to liberal visions of 'global governance' (see GOVERNANCE, GLOBAL).

The central idea of ultra-imperialism, that capitalism induces great-power cooperation, has always been challenged. In Kautsky's time, revolutionary Marxist critics such as Lenin and Bukharin said that imperialism was a structural feature of mature capitalism and peace or agreement between the powers would always be disrupted by the unevenness and crises of capitalist development. Kautsky's concept of ultra-imperialism was accused of contributing

underconsumption

to the betrayal of socialist internationalism by the Second International in the 1914-18 war, because it blunted opposition to World War I by suggesting an appeal to peaceful capitalists, fostering quiescence among workers which demobilized them in the face of jingoism. More fundamentally, Marxism (see MARXISM-Leninism) classically differs from Liberalism in repudiating the identification of capitalism with 'rational' distribution of resources and asserting that the pursuit of profit can lead to mutual destructiveness and irrationalities, both macro-economic (crises, overproduction and so on) and political (war). Kautsky's concept implicitly excised this contradiction from the theory of capitalism.

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ANDREW WRIGHT

underconsumption

The term 'underconsumption' designates insufficient demand, compared to a product supply, under given prices. Underconsumption means relative OVERPRODUCTION of COMMODITIES, because there is overproduction in relation to effective demand.

The dominant view of the Classical School of political economy, based on SAY'S LAW, refused the possibility of overproduction in the long run, because every growth in production would create by itself an equal augmentation in demand, as products are paid for with other products. Therefore, if certain products rested unsold, it was because other products had not yet been produced. This means that CONSUMPTION power will necessarily be increased with every increase in productive power and thus overproduction would emerge only if underproduction had occurred.

Simonde de Sismondi and THOMAS ROBERT MALTHUS were the first to question Say's Law and the pioneers of the theories of underconsumption. Considering that consumption is not necessarily the logical consequence of production, both criticized the main postulate of Say's Law, that products are paid for with other products, which means that money circulation is disregarded and commodity circulation is seen as an uninterrupted process on the basis of barter. But, as money comes in between buying and selling, the possibility of an overproduction crisis cannot be excluded, since a seller, having the discretion to keep their wealth in money form, is not obliged to buy.

The underconsumption theories can be reduced to the following propositions. First, within the capitalist economy there is an inherent tendency towards economic crises of generalized overproduction, due to the lack of effective demand. Second, when aggregate demand is below supply, there is no endogenous dynamic process towards full employment equilibrium, because demand has the priority over supply; it is demand that triggers off and regulates production and not the opposite, as Say's Law presupposes.

However, there are differences among economists who have supported the possibility of crises due to insufficient demand. The first category includes approaches which consider oversaving as the main cause of crises and unemployment. Thomas Malthus (who had presupposed that the increase in invested savings augments aggregate production disproportionately to the augmentation of society's consumption power) and JOHN MAYNARD KEYNES (who had argued that planned savings, increasing faster than planned investments, reduce aggregate demand) are historically the main representatives of this notion. The second category includes the views which consider that (given the increase in labour productivity and therefore the increase of the aggregate product), the main cause of crises and unemployment is labourers' inability to consume the product that they have produced, due to their low wages. Sismondi and Karl Johann Rodbertus are the founders of this conception.

ROSA LUXEMBURG (who has been called the 'queen' of underconsumption theory), basing her thinking on aspects of the economic analysis of KARL MARX, worked on a similar direction.

In any case, the underconsumption theories, considering economic crises as crises in the area of commodity circulation, investigate only one side of economic phenomena – the market and distribution relations – neglecting the sphere of production.

See also:

disproportionality; Hobson, J(ohn) A(tkinson)

Further reading

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GEORGE E. ECONOMAKIS

underdevelopment

There are numerous ways of defining 'underdevelopment'. One common and static way of defining underdevelopment is to list those characteristics which differentiate the unmodernized, traditional, poor, less-developed, developing, low-income, dependent or Third World countries (sometimes also referred to as

the periphery or the SOUTH) from the advanced, modern, rich, developed, high-income, centre or First World countries (sometimes referred to as the North). From a dynamic viewpoint, underdevelopment is analysed as a process of change which is distinct from the process of change undergone by the developed countries (DCs). This entry is restricted to the static version of the term, as the dynamic version is analysed in the entry DEVELOPMENT OF UNDERDEVELOPMENT. For competing views on the causes of underdevelopment, see entries ON DEPENDENCY THEORY, MODERNIZATION THEORY, NEO-CLASSICAL ECONOMICS, NEO-LIBERALISM and STRUCTURALISM.

There are several different ways of classifying countries, each of which has its strengths and weaknesses. The WORLD BANK uses per capita income level to classify countries into low-income, middle-income, upper-middle-income and high-income economies. Almost all those in the first three categories are considered to be underdeveloped or less-developed countries (LDCs). According to this classification, there are approximately 150 LDCs and about 20 DCs. The UNITED NATIONS (UN) differentiates LDCs into three categories: (1) the LEAST-DEVELOPED COUNTRIES (LLDCs), which are the poorest 46 countries; (2) the 88 non-oil-exporting developing countries; and (3) the 13 petroleum-producing countries that have become rich since the dramatic increase of the oil price in the 1970s, but still display some characteristics common to LDCs.

To overcome some of the limitations of using income as the sole indicator of underdevelopment, the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP) developed a Human Development Index (HDI). This composite indicator includes three basic components which aim to present a more accurate reflection of well-being: longevity, as measured by life expectancy; knowledge, calculated by adult literacy and years of schooling; and standard of living, valued by purchasing power or real per capita income adjusted for the local cost of living. The ranking of countries according to these two scales does indeed vary, reflecting the

underdevelopment thesis

different priorities which governments and societies attach to education, health and basic needs, among other things.

Thus underdevelopment can be characterized in a variety of ways, but usually refers to low levels of income, life expectancy, health and sanitation, food intake, nutrition, and human security. Although there have been significant improvements in the above-mentioned indicators since the 1950s, one-third of the population of LDCs still live in absolute poverty and one-third of the adult population are illiterate (of whom two-thirds are women).

Despite increasing diversity, LDCs still share many characteristics which differentiate them from DCs. LDCs account for about four-fifths of the world's population, cover more than two-thirds of the world's land area, but produce only about two-fifths of the world's output. Thus 80 per cent of the world's population subsists on 20 per cent of the world's income. In addition to low standards of living and high rates of POPULATION GROWTH, LDCs are further characterized by dependence on agricultural production and primary-product exports, low levels of productivity, high levels of unemployment and underemployment, a highly unequal distribution of income, imperfect markets and high degrees of dependence on and vulnerability to international forces that are largely shaped by a few dominant countries.

See also:

development; developing countries; Third World

Further reading

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CRISTÓBAL KAY

underdevelopment thesis

The 'underdevelopment thesis' has evolved through several permutations during the last fifty or so years. In very general terms, the underdevelopment thesis argues that the economic DEPENDENCE OF DEVELOPING COUNTRIES on the advanced capitalist countries leads to economic stagnation and the worsening of income distribution. In neo-Marxist terms (see NEO-MARXISM), underdevelopment occurs as a result of the spread of CAPITALISM from the centre countries to the peripheral countries (see CORE-PERIPHERY MODEL).

Interestingly, Africa, Asia and Latin America were not of major interest to KARL MARX. He regarded production in these regions as

feudal and backward when compared to the more progressive modes of capitalism. Thus, he saw the introduction of European capitalism in these regions as beneficial. But, in the twentieth century, Marxian analysis (see MARXIAN ECONOMICS) came to encompass an international class struggle, including the conflict between rich and poor countries. LENIN provided much of this new Marxian revision. He argued that it was essential to recognize the difference between the MONOPOLY CAPITALISM of his period and the competitive capitalism of Marx's day. According to Lenin, a logical outgrowth of the monopoly stage of industrial and finance capitalism is the imperialist domination of poor countries by rich countries (see IMPERIALISM).

In the 1950s and early 1960s, Lenin's concepts of imperialism and international class conflict were extended and refined into a theory of economic growth and stagnation by the leading US Marxist, PAUL BARAN. For Baran, a capitalist revolution in the developing world was unlikely because of Western economic and political domination, especially in the colonial period. Capitalism arose not through the growth of small competitive firms in the domestic economy, but through the transfer from abroad of advanced monopolistic business.

ANDRE GUNDER FRANK, writing in the mid-1960s, built on these lines of argument by criticizing the view of many DEVELOPMENT scholars that contemporary, underdeveloped countries resemble the earlier stages of now-developed countries. Many of these scholars viewed modernization in developing countries as simply the adoption of economic and political systems developed in Western Europe and North America.

For Frank, the present developed countries were never underdeveloped, though they may have been undeveloped. The Frank thesis of UNDERDEVELOPMENT argues that underdevelopment does not mean traditional economic and political and social institutions, but instead the developing countries' subjection to the colonial rule and imperial domination of foreign powers. In essence, Frank sees under-

development as the effect of the penetration of modern capitalism into the archaic economic structures of the THIRD WORLD. He sees the DEINDUSTRIALIZATION of India under British colonialism, the disruption of African society by the slave trade and subsequent COLONIALISM, and the total destruction of Inca and Aztec civilizations by the Spanish as examples of the creation of underdevelopment.

To Frank, the economic development of the rich countries contributes to the underdevelopment of the poor. Development in LESS-DEVELOPED COUNTRIES (LDCs) is not self-generating or autonomous but ancillary. The LDCs are economic satellites of the highly developed regions of North America and Western Europe in the international capitalist system. The Afro-Asian and Latin American countries most weakly integrated into this system tend to be the most highly developed. Japanese economic development after the 1860s is the classic case illustrating Frank's theory: Japan was never a capitalist satellite.

Frank suggests that satellite countries experience their greatest economic development when they are least dependent on the world capitalist system. Thus Argentina, Brazil, Chile and Mexico grew most rapidly during World War I, the GREAT DEPRESSION and World War II, when trade and financial ties to major capitalist countries were weakest. Significantly, the most underdeveloped regions today are those that have had the closest ties to Western capitalism in the past. They were the greatest exporters of primary products to and the biggest sources of capital for developed countries, and were abandoned by them when for one reason or another business fell off. Frank points to India's Bengal; the once sugar-exporting West Indies and north-eastern Brazil; the defunct mining districts of Minas Gerais in Brazil, highland Peru and Bolivia, and the former silver regions of Mexico as examples.

It is an error, Frank feels, to argue that the development of the underdeveloped countries will be stimulated by the indiscriminate transfer of capital, institutions and values from developed countries. He suggests that, in fact,

undervaluation of currencies

the following economic activities have contributed to underdevelopment not development:

- 1 the replacement of indigenous enterprises with technologically more advanced, global, subsidiary companies;
- 2 the formation of an unskilled labour force to work in factories and mines, and on plantations;
- 3 the recruiting of highly educated youths to junior posts in the colonial administrative service;
- 4 the migration of workers from the villages to the foreign-dominated urban complexes, and
- 5 the opening of the economy to trade through investment from developed countries.

According to Frank, a Third World country can only develop by withdrawing from the world capitalist system.

The underdevelopment thesis has been and continues to be influential, although major adjustments in this approach have had to be made in recent years to take into account the demise of the USSR and explain the success of East Asian states such as Hong Kong, Singapore, South Korea and Taiwan. Also, the rise of NEO-LIBERALISM has won advocates by attributing underdevelopment to internal dynamics in the developing country. In this view, underdevelopment is caused by poor resource-allocation related to incorrect state pricing policies, corruption and inefficiency, and a lack of economic incentives.

See also:

dependency theory

Further reading

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ROBERT LOONEY

undervaluation of currencies

The undervaluation of a currency occurs when the currency's value in terms of another currency is thought by financial operators to be inferior to the 'right' value. The economic concept which allows the identification of the 'right' value of a currency in terms of another currency is the so-called 'PURCHASING POWER PARITY (PPP) theory'.

L.S. TALANI

underwriting

The term 'underwriting' may refer to two completely different activities. The first meaning refers to the practice of general insurance institutions (as opposed to life insurance ones) which 'underwrite' (that is, guarantee) the risk of damage or destruction of ships, aircraft, property and so on. In exchange for this service, a general insurance company charges a premium which is proportionate to the risk it is underwriting and, if the sum of premiums exceeds the claims it has to pay, it is possible to speak of the existence of an 'underwriting profit'.

However, the most widespread use of the term 'underwriting' refers to an established practice in the STOCK MARKET, according to which big investors, particularly institutions, agree for a fee to buy undersubscribed new securities issues. New securities issues are

undersubscribed when there are applications for fewer stocks or shares than are on offer. Those institutions that agree to buy unsold issues are called 'underwriters', while those that agree to buy only a maximum number of shares if required to do so are called 'sub-underwriters'. The possibility of recurring to underwriting facilitates the issuing of shares by many small or new companies, which are thus sure of getting the whole amount of money they need.

Underwriting facilities are arranged by the many INVESTMENT BANKS operating in the stock markets who, in exchange for the payment of fees, sponsor the issue, thereby guaranteeing it to the likely investing institutions. Underwriting fees are usually given by a percentage of the value of the shares on offer and they represent a very important source of income for both the merchant banks and the investing institutions involved in the practice of underwriting.

In the majority of cases, neither sub-underwriters nor underwriters are left with the securities issued, which are usually placed in the primary market (see MARKETS, PRIMARY). However, when the new issues are undersubscribed and left with the underwriters, the shares are said to be 'overhanging the market' and their price is very likely to decrease until all of them are placed in the hands of investors who really want to keep them.

Underwriting facilities may be provided not only for new securities issues, but also for 'rights issues'. The term 'rights' refers here to the right of existing shareholders to buy new company shares before any other investor. These rights issues are usually underwritten by investors to ensure that the issuing company gets the money it needs.

L.S. TALANI

unemployment, hidden

Generally, hidden unemployment is unemployment not measured by official unemployment statistics. A widely accepted definition, however,

does not exist. Hidden unemployment consists of several components defined differently across countries. The first component consists of discouraged workers. If economic activity declines, individuals may leave the labour force or decide not to enter it. They want work, but feel no suitable job is available. Since they fail the jobsearch criterion, they are often excluded from the labour force. The second component comprises those involuntarily employed part-time. They work fewer hours than they want because of economic slack. The economy's labour resources are thus under-utilized. This underemployment remains unregistered because unemployment is measured in terms of people rather than hours. The third component consists of individuals unable to find a job, but taking up other social benefits that are more generous than unemployment compensation. Beneficiaries of disability benefits, for example, may actually be unemployed, in whole or in part. In general, the existence of social security schemes reduces the number of employed workers, thereby creating hidden unemployment. The fourth component comprises unemployed job-seekers who participate in employment and training programmes. As a result, they are no longer registered as unemployed.

M. PETER VAN DER HOEK

unemployment, natural rate of

The 'natural rate of unemployment' (sometimes called the NAIRU or 'non-accelerating inflation rate of unemployment') is the rate at which the labour market is in an equilibrium state, where the number prepared to work for the prevailing real wage equals the number of jobs available. Measured unemployment is not zero because some people in the labour force will not consider the prevailing wage adequate for them to offer themselves for work; others will be moving between jobs and temporarily treated as unemployed (so-called 'frictional' unemployment); while for others, a mismatch of skills between those possessed by prospective workers and those required in the marketplace,

unequal development

or a geographical separation of job opportunities and workers, may constrain take-up of vacancies.

The natural rate of unemployment is largely a monetarist concept (see **MONETARISM**). Some economists dislike the word 'natural', as it implies inevitability and provides excuses for inaction, and there are differences of view on the extent to which measured unemployment up to the natural rate can be considered 'voluntary'.

Attempts by government to reduce unemployment below the natural rate by stimulating aggregate demand (for example, by increasing public expenditure or reducing taxation) will result only in increased **INFLATION**. In principle, such policies can, however, reduce unemployment if it is above the natural rate, when the gap between the actual level and the natural rate is assumed to be due to a deficiency in aggregate demand. Supply-side policies (see **SUPPLY-SIDE ECONOMICS**) that may reduce the natural rate itself include the provision of job-vacancy information services (such as job centres), retraining and public employment programmes. Some commentators would like to see such 'carrot' policies combined with the 'stick' of tighter controls on unemployment benefits, increases in which are thought by some to explain the apparent substantial rise in the natural rate of unemployment in recent decades.

JOHN CLARK

unequal development

At the most general level, the concept of 'unequal development' refers to processes of global economic development that result in the 'vertical division' or stratification of the world economy into differentially advantaged/disadvantaged sectors. It may also refer to analogous processes operating within national economies and producing significant interregional inequalities in economic and social development. However, a more precise and theoretical use of the concept is to be found in studies produced

by Marxist and neo-Marxist scholars (see **MARXISM-LENINISM**; **NEO-MARXISM**) working within the frameworks of dependency, **WORLD-SYSTEMS** and **UNEQUAL EXCHANGE** theory, for whom global inequality is the product of systemic processes of **EXPLOITATION** of poorer countries by richer ones. Among these scholars, Samir Amin is perhaps most closely associated with the term 'unequal development', since it is the central organizing concept of his analysis of the world economy.

Whereas the concept of '**UNEVEN DEVELOPMENT**' suggests that nations, countries and regions develop at different paces or tempos under the impact of an indeterminate combination of 'endogenous' and 'exogenous' factors, the concept of 'unequal development' involves the proposition that asymmetric relations of power among the units of an increasingly integrated international capitalist order are the cause as well as the result of an entrenched structure of global economic inequality. Though theorists of unequal development differ as to the mechanisms that produce and reproduce this structured global inequality, they agree that transfers of economic surplus and/or 'value' across national lines are central to these processes. General agreement also exists that the 'expanded reproduction' of the industrialized capitalist countries has depended historically and continues to depend on their capacity to restrict, distort and retard the economic growth potential of the non-industrialized colonial and semi-colonial world.

For **ANDRE GUNDER FRANK**, in an early formulation, the capitalist world economy is divided between developed 'metropolitan' and underdeveloped 'satellite' countries, the condition for the success of the former being the continuing exploitation of the latter – 'the **DEVELOPMENT OF UNDERDEVELOPMENT**'. The metropolitan-satellite relationship also obtains in relations between and within underdeveloped economies. For **IMMANUEL WALLERSTEIN** and other world-systems theorists, the modern capitalist world system is conceptualized as a hierarchical totality embracing 'core', 'semi-peripheral' and 'peripheral' sectors (see **CORE-PERIPHERY MODEL**; **SEMI-PERIPHERY**).

Amin's account of unequal development proceeds from a critique and reformulation of the theory of unequal exchange originally proposed by Arghiri Emmanuel. According to Amin (1976), unequal processes of capitalist development have produced 'central' and 'peripheral' forms of the capitalist **MODE OF PRODUCTION**. In peripheral countries, capitalist and non-capitalist modes of production co-exist, but non-capitalist modes are dominated by the capitalist mode. The peripheral form of the capitalist mode of production is characterized by modern technology making possible high productivity levels and by persistently low wages in the context of the international immobility of labour. These conditions allow for unequal exchange in world markets (the sale of commodities produced in the periphery at prices persistently below their actual value) and for the net transfer of large magnitudes of **SURPLUS VALUE** from peripheral to central capitalist countries. Once it is grasped that the accumulation of capital occurs on a world scale and on the basis of transfers of surplus value from peripheral to central capitalist formations, it is apparent that the global development of capitalism must occur 'unequally'.

Marxist theorists of unequal development generally conclude that the only way out of the cycle of dependency and exploitation in which peripheral countries are enmeshed is through socialist revolution (see **SOCIALISM**). Socialized means of production, a state monopoly on foreign trade and central planning in the allocation of economic resources are deemed to be the necessary conditions for the '**DELINKING**' of such countries from the global circuits of capital which perpetuate global inequality. For some world-systems theorists, however, nationally isolated socialist revolutions in comparatively backward countries cannot produce conditions that are sufficient for an authentically socialist development. Rather, the attempt to build '**SOCIALISM IN ONE COUNTRY**' can only lead to 'deformed workers' states' or to 'state capitalism'. From this perspective, a satisfactory solution to the problem of unequal development can only be

realized on the basis of a socialist world system.

See also:

disengagement; underdevelopment thesis; value theory

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MURRAY E.G. SMITH

unequal exchange

The theory of unequal exchange is associated primarily with Arghiri Emmanuel, whose ideas were first published in French in 1962 in a book written jointly with the French Marxist,

unequal exchange

Charles Bettelheim. However, Emmanuel's ideas became more widely known with the publication in English of *Unequal Exchange: The Imperialism of Trade* (1972).

In *Unequal Exchange*, Emmanuel points to the hypocrisy of the apologists for the existing structure of world trade for arguing that, for primary products, wages are a function of prices, but for manufactured goods prices are a function of wages. As a result, he claims, the rich countries justify protection of manufactures by reference to the low wages of and dumping from poorer countries.

Emmanuel's theory is based on the premise that costs of production determine prices, with demand merely determining the quantity supplied. Wages are given institutionally, through bargaining, and Emmanuel argues that not only can they rise above subsistence level but, in the rich countries, they do – driven up by the power of organized labour. By contrast, in the LESS-DEVELOPED COUNTRIES (LDCs), workers are badly organized, unions are weak and wages in both money and real terms rise slowly, if at all. When this inequality of bargaining power is added to a pattern of international specialization through technology and to a tendency towards the international equalization of the rate of profit given by capital mobility, the stage is set for 'unequal exchange'.

Exchange is unequal in the sense that the barter TERMS OF TRADE of the poorer countries are worse than they would be if real wages, after allowing for differences in productivity, were equal in the poor countries to those in the rich. Thus, whereas in the theory of RAUL PREBISCH the poor countries lose out in terms of weak external terms of trade because of their relative specialization as primary producers, in Emmanuel's unequal exchange the poor countries suffer as low-wage countries regardless of the type of product.

Not only are workers in the poorer countries super-exploited, but also (in Emmanuel's model) the inequality is cumulative: higher wages in the centre generate the market for further technical progress and industrialization

in the centre. Unequal exchange is therefore self-perpetuating.

Most of the arguments about *Unequal Exchange* have focused on two issues. The first is whether real wages are in fact lower in poor countries once allowance is made for productivity differences. The second issue is best summarized in the form of a question: If rates of exploitation in poor countries, such as India, are so much higher than in rich countries, why doesn't FOREIGN DIRECT INVESTMENT (FDI) flow into the poor countries to produce more and more goods until the wage (allowing for productivity differences) is equalized? Possible answers to this question are either that the production conditions must be different in the two countries or that transport costs and/or protection must drive a wedge between the prices, so that the production of cloth in, say, India, is less profitable than in, say, the United Kingdom, despite the latter's higher wage costs per unit. Thus poor countries may gain from international trade, but due to conditions of unequal exchange their gains are much less than if exchange were equal. According to Emmanuel (1972: 368), price support for the exports of LDCs through commodity cartels would go some way to eliminating unequal exchange.

See also:

comparative advantage: core-periphery model; Marxian economics

Reference and further reading

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CHRIS EDWARDS

uneven development

'Uneven development' is a concept in Marxist (see MARXISM–LENINISM) and radical political economy – though used more widely as a descriptive term – asserting that social development (economic growth, cultural, political and social structural change) is not homogeneous. At its simplest, it denotes differences in the conditions or level of development between nations, regions, branches of the economy or firms. More interestingly, it explores differences in the pace and pattern of development itself. The spectrum of forms and hierarchies of economic and political power is constantly disrupted by disparities in the pace of DEVELOPMENT – units fall behind, others catch up and overtake.

Uneven development is not really a theory, but an 'algebraic' concept that requires also a theory of the nature and dynamics of development. Since these differ, so too do expectations of the effects of unevenness. One tradition criticizes liberal expectations of universal benefits and equalizing tendencies of the world market, arguing that disparities in national development would polarize further in the absence of special policy measures. This case began with proponents of INFANT-INDUSTRY PROTECTION and continues in contemporary underdevelopment theory (see UNDERDEVELOPMENT THESIS). This may, however, seem to be a one-sided argument, anticipating only polarization and neglecting the process of catching up and falling behind. Indeed, in economic terms debate still centres around this issue, since the contemporary world displays both polarization and catching up.

The mechanism of polarization is contentious, but seems at least in part to derive from advantages of early development. Early industrializing nations acquire the general preconditions for further cumulative growth – technical and social infrastructure, labour skills, accumulated capital, tools and techniques promoting labour productivity, access to markets and so on – and since this development is itself cumulative, this raises the general 'entry level' required for all industrializers.

Conversely, if a nation is able to find some lever to concentrate enough surplus and create infrastructural preconditions, it acquires certain 'advantages of backwardness'. This idea – central to the law of combined and uneven development formulated by Leon Trotsky and echoed, apparently independently, by the liberal economist ALEXANDER GERSCHENKRON – implies that relative late-comers can benefit from entering the developmental race with the latest technical methods, without repeating the path of technical innovation that produced them; while earlier developers suffer from embedding their infrastructure, capital and labour in outdated technology or products. The result is a leapfrogging process whereby relative latecomers 'catch up' and leaders fall behind.

Such processes were first systematically theorized by KARL MARX in his theory of competition between firms and (though insufficiently widely realized) it is central to his theory of accumulation and crisis – indeed, Marx's theory of capitalism encompasses both polarization and equalization within and between nations.

Uneven development disrupts the international political pecking order – especially when economic challengers emerge to claim the status of front-rank power. Theorists like LENIN and the realist ROBERT GILPIN see it as a major cause of war and obstacle to international COOPERATION and HEGEMONY.

Global unevenness and imbalances can also obstruct growth, trade, management of the world economy and supranational INTEGRATION (as evidenced by the problems of EUROPEAN COMMUNITY (EC) 'harmonization').

unionization

This is the rationale behind 'international Keynesian' arguments for international economic redistribution and management (by coordination or 'hegemonic leadership' – see KEYNESIAN ECONOMICS). Absence of such policies was famously argued by CHARLES KINDLEBERGER to be a major cause of the inter-war world crisis (see HEGEMONIC STABILITY THEORY).

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ANDREW WRIGHT

UNION DOUANIÈRE ET ECONOMIQUE DE L'AFRIQUE CENTRAL (UDEAC) *see* Central African Customs and Economic Union (CACEU)

unionization

TRADE UNION organization varies across segments of national labour markets, over time and from country to country. Structural, business-cycle and institutional theories account for these three kinds of variation.

Structural explanations relate unionization to industrial, occupational and demographic characteristics of labour markets. Early British and US studies found that manufacturing sector workers were highly unionized compared to those in agricultural and service sectors. This pattern is general throughout Western Europe and North America. A new sectoral effect developed after World War II as public-sector

growth boosted union organization. Unions acquired collective-bargaining rights for public employees in the 1960s and public-sector unions expanded rapidly from this time. Unionization also varies by occupational and demographic group. Union organization is generally higher among manual workers than white collar workers. There is also a widespread gender gap in unionization. In the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries, for example, men are more likely to be union members than women.

While the structural account studies variation within labour markets at a single point in time, the business-cycle theory associates changing unionization with fluctuating economic conditions. Research finds strong evidence for the positive effects of INFLATION and the negative impact of unemployment. According to the business-cycle explanation, inflation raises unionization because workers organize to protect their wages and employers accede to labour organizing when prices are rising. Unemployment suppresses union growth because employers resist unions when labour markets are slack. Under these conditions, the costs of industrial action to employers are small. For workers, union membership provides few benefits and is very costly during spells of joblessness. These business-cycle effects have been found in Western Europe, North America and Australia.

Despite strong findings, neither structural nor business-cycle accounts explain cross-national differences in unionization. The percentage of the labour force unionized varies from about 90 per cent in Sweden to about 15 per cent in the United States, but structural and economic trends are broadly similar across the industrialized countries. Manufacturing employment declined and services grew, while the strong economic growth of the 1950s and 1960s was replaced by rising unemployment from the early 1970s. Common structural and economic conditions cannot explain cross-national variation, but institutional theories have been proposed to account for differences in unionization across countries.

Institutional theories of unionization highlight collective-bargaining centralization, the role of the STATE and union-controlled unemployment insurance. In some countries, notably in Scandinavia, collective bargaining is centralized and national collective agreements determine wages. With centralized bargaining, unions and employers have signed mutual recognition pacts and union wages are often extended to non-union workplaces. Employer opposition to unions is low because mutual recognition pacts legitimize unions as labour-market actors and extension procedures impose the costs of unionism on non-union workplaces. High unionization results. With decentralized bargaining, as in the United States, union contracts only cover certain plants or firms. Unions compete with employers for the right to represent workers. Employers' institutionalized opportunity to oppose union organizing under decentralized bargaining lowers unionization.

State policy also influences unionization. Social democratic governments (see SOCIAL DEMOCRACY) reformed industrial-relations institutions to expand unions' economic influence. Most important in the post-war period, labour governments supported public-sector unionization and included unions in national economic policy-making. While social democrats often supported unionization, conservatives have opposed unions. For instance, the Republican administration under President Reagan in the United States and the Conservative government under Prime Minister Thatcher in the United Kingdom restricted union rights and union organization fell dramatically in both countries through the 1980s.

Finally, cross-national variation in unionization is closely related to union-run systems of unemployment insurance, called 'Ghent systems' after the Belgium town which popularized such schemes. Ghent systems, or some variant of them, are found in Belgium, Denmark, Finland and Sweden. Although unemployment insurance is generally not contingent on union membership in these countries, workers retain close ties to unions during spells

of unemployment and benefit claims may be processed more efficiently for union members. Under these conditions, workers at risk of unemployment have strong incentives for union membership and membership continues through spells of unemployment. Consequently, unionization is extremely high in these countries, compared to the other countries of the OECD. The Ghent system also reverses the unemployment effect of business-cycle theory. Unionization rises with unemployment in Ghent-system countries, because workers have incentives to join unions when unemployment is high.

In addition to these three institutional conditions, the size of the labour force is also closely related to cross-national patterns of unionization. To explain this association, researchers argue that the benefits of union organization depend on the proportion of the workforce organized, but the cost of organization to the union depends on the absolute number of new union members. As a result, the optimal level of unionization for the union falls as the size of the labour force increases. Countries with small populations, like Sweden or Finland, have very high unionization, while countries with large populations, like the United States or Japan, have low unionization.

See also:

class, working; corporatism; institutionalism; labour relations; social democratic parties; wages

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unitary taxation

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BRUCE WESTERN

UNIT TRUSTS see mutual funds

unitary taxation

The most widely used method of taxing MULTINATIONAL CORPORATIONS (MNCs) is 'separate accounting', whereby the profits of a branch or subsidiary of an MNC are taxed as if the branch or subsidiary were separate entities. However, some states believe that this disadvantages them. MNCs, by definition, operate in several jurisdictions, which affords them some latitude to avoid taxation – for instance by incorporating their head office in a low-taxation area (see BILATERAL DUAL-TAXATION TREATIES) or TAX HAVEN, or by using TRANSFER PRICING.

Unitary taxation is an attempt by the state to redress the fact that MNCs traverse legal jurisdictions and may exploit regulatory differences to their advantage. The unitary method assumes that profit is derived from the business as a whole, rather than from a part of it which is located in a particular state. Thus authorities calculate, using 'formula apportionment', the global income of MNCs and tax the MNC according to the proportion of its worldwide operations that take place in their state. The accounting method of California, known as 'Worldwide Combined Reporting' (WWCR), is one of the most inclusive forms of unitary taxation, as it calculates the rate of tax payable to California on the basis of the percentage of

the MNC's global property, payroll and sales located in California. Thus, if an MNC had 3 per cent of its global payroll, 7 per cent of its global sales and 10 per cent of its global property located in California, the tax authorities would calculate the average (6.7 per cent) and tax that percentage of the MNC's global income.

Many states of the United States used to operate a unitary method (although now only four do so) for US corporations with operations in more than one state of the union. If all states in which the corporation makes profit use this system, it is fair since it apportions to each state the proper amount of tax based on the proportion of the corporation's operations in their jurisdiction and avoids DOUBLE TAXATION for the corporation. However, MNCs which operate both in jurisdictions that use separate accounting and in those that use the unitary method have raised many objections. They have argued that they are subject to double taxation under the unitary method, since formula apportionment includes profits on which the MNC has paid tax elsewhere. Also, the higher wages and property values (particularly in California) inflates unfairly under WWCR the proportion of the business taxable in California (that is, an MNC may employ many more people in, say, Africa than in California, but the higher wages in California make it appear on paper to have more personnel in California). Moreover, there is no reliable method of accounting for overvalued currencies when converting into US dollars the percentage of business located outside the United States. Finally, MNCs have argued that there are considerable additional costs in maintaining special accounting procedures for WWCR.

Numerous court cases (most recently concerning Barclays Bank) and threats of retaliation by numerous governments have led to a revision of California's WWCR known as 'Water's Edge' accounting, which calculates (in certain circumstances and for the purposes of taxation only) the MNC's property, payroll and sales in the United States, rather than globally. The debate in principle about the

taxation of MNCs, however, continues and probably will do so as long as the two standards are used. Although difficult to achieve, perhaps the most appropriate system of taxation would be for a common rate to be adopted by all states.

JARROD WIENER

United Nations (UN)

The United Nations (UN) is an organization of sovereign states. In accordance with its predecessor, the League of Nations, its primary goal is to maintain international peace and security. Its second objective is the promotion of international economic and social cooperation. A third professed purpose of the UN is to promote respect for human rights for all people.

The name 'United Nations' was first used during World War II when representatives of twenty-six nations pledged their governments to continue fighting together against the Axis Powers. The United Nations officially came into existence on 24 October 1945 when the Charter – the international Treaty on which the UN is based – had been ratified by China, France, the Soviet Union, the United Kingdom, the United States and a majority of other signatories who had agreed on an earlier proposal.

The UN has six main organs:

- 1 The General Assembly, sometimes described as the nearest thing to a world parliament, is the main deliberative body. All member-states (almost 200) are represented in it and each has one vote. Decisions on ordinary matters are taken by simple majority. Important questions require a two-thirds majority.
- 2 The Security Council is the organ to which the Charter gives primary responsibility for maintaining peace and security. It can be convened at any time, whenever peace is threatened. Member-states are obliged to carry out its decisions, although they do not always do so. The Council has fifteen

members. Five of these – China, France, the Russian Federation, the United Kingdom and the United States – are permanent members. The other ten are elected by the Assembly for two-year terms. Decisions require nine votes, except in votes on procedural questions; a decision cannot be taken if there is a negative vote by a permanent member (known as the 'veto'). The Council also makes recommendations to the General Assembly on a candidate for Secretary-General and on the admission of new members to the UN.

- 3 Working under the authority of the General Assembly, the ECONOMIC AND SOCIAL COUNCIL (ECOSOC) coordinates the economic and social work of the UN and related specialized agencies and institutions.
- 4 The Trusteeship Council was established to ensure that governments responsible for administering Trust Territories take adequate steps to prepare them for self-government or independence. Since 1994, the Trusteeship Council has been in abeyance.
- 5 The International Court of Justice (also known as the World Court) is the main judicial organ of the UN, settling legal disputes between member-states and giving advisory opinions to the UN and its agencies. It consists of fifteen judges, elected by the General Assembly and the Security Council.
- 6 The Secretariat works for the other five organs of the UN and administers their programmes, carrying out the day-to-day work of the UN. At its head is the Secretary-General, who plays a merely administrative role, authorized to bring situations to the attention of various UN organs and to 'perform such functions as are entrusted to him'. These include the Secretary-General's position as an impartial party in effecting conciliation when the general objectives of the UN are at stake.

All these organs are based at UN headquarters in New York, except the International Court of Justice which is located at The Hague in the Netherlands. However, many official UN meetings also take place at Geneva in Switzerland.

United Nations Centre for International Trade Law (UNCITRAL)

The UN and all its specialized agencies, such as the United Nations Children's Fund (UNICEF), UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), FOOD AND AGRICULTURE ORGANIZATION (FAO), INTERNATIONAL MONETARY FUND (IMF), WORLD HEALTH ORGANIZATION (WHO), INTERNATIONAL LABOUR ORGANIZATION (ILO) and also INTERNATIONAL TELECOMMUNICATION UNION (ITU) constitute together the UN system.

J.E.C. ENGELBERTS

United Nations Centre for International Trade Law (UNCITRAL)

The United Nations Commission on International Trade Law (UNCITRAL) was established by General Assembly Resolution 2.205 (XXI) of 17 December 1966 and became fully operative on 1 January 1968. UNCITRAL was charged with the mandate to 'further the progressive harmonization and unification of the law of international trade' through developing international conventions, model laws and uniform laws; promoting the codification of trade terms, customs and practices, and coordinating the activities of the various agencies concerned with international trade (such as the INTERNATIONAL CHAMBER OF COMMERCE (ICC) and Unidroit). There can be little doubt that such harmonization of private commercial law has contributed to the process of GLOBALIZATION.

UNCITRAL has taken a truly global perspective in the elaboration of international commercial rules. Its membership consisted of representatives from the principal economic and legal systems of the world: nine delegates from Africa, seven from Asia, five from Eastern Europe, six from Latin America and nine from the industrialized countries. The aim was to depoliticize the application of international trade law: if the political battles occurred during the drafting stages of common rules, the rules would emerge with universal acceptance.

Among UNCITRAL's notable achievements in the area of uniform laws are its Convention on the Limitation Period in the International Sale of Goods (New York, 1974); the Convention on the Carriage of Goods by Sea (Hamburg, 1978); the Convention on Contracts for the International Sale of Goods (Vienna Sales Convention, 1980); the Convention on Bills of Exchange and Promissory Notes (New York, 1988), and the Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991). UNCITRAL has also completed numerous model laws, such as the Procurement of Goods and Construction (1993), a Model Law Incorporating Services Procurement Procedures (1994) and is continuing work on a Uniform Law on Guarantees and Set Rules on Electronic Data Interchange.

In the area of international commercial arbitration, UNCITRAL has elaborated a set of Arbitration Rules (1976), Conciliation Rules (1980) and a Model Law on International Commercial Arbitration (1985). UNCITRAL rules have been adopted as the institutional rules of such diverse tribunals as the Inter-American Commercial Arbitration Commission (IACAC) and of the Regional Arbitration Centres under the Asian-African Legal Consultative Committee (AALCC). Other permanent arbitral tribunals, such as the London Court of Arbitration and the American Arbitration Association have amended their institutional rules to accommodate parties wishing to make use of the UNCITRAL rules. UNCITRAL rules have also been used in the IRAN-US CLAIMS TRIBUNAL, which is a testament to their acceptability to parties with very different legal systems.

JARROD WIENER

United Nations Centre on Transnational Corporations (UNCTC)

The United Nations Centre on Transnational Corporations (UNCTC) was established in

1974 as an information and research centre, charged with evaluating the activities of transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) and improving the bargaining position of host governments of developing countries towards TNCs. In 1993, UNCTC was closed and its activities transferred to the Division on Transnational Corporations and Investment (DTCI) of the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD).

MEHDI PARVIZI AMINEH

United Nations Conference on the Law of the Sea

The United Nations Conference on the Law of the Sea is a continuing conference established by the UNITED NATIONS (UN) in 1958 to develop a legal structure to govern the use of the earth's oceans. These were previously governed by common law applications, but technological changes brought larger areas of the oceans into potential use and abuse (through pollution). The ocean bodies were divided into three zones in common law usage:

- 1 *res nullius* (RN), comprising waters outside claimed territorial limits but which states accepted could be incorporated by the adjacent country, according to accepted rules;
- 2 *res extra commercium* (REC), which covers those parts of the oceans that cannot be claimed as part of any country's territory but can be used by all for their own purposes, subject to agreed rules;
- 3 *res communis humanitatis* (RCH), comprising areas that are not only beyond national state claims but also recognized as the common property of all humanity, from which any returns from exploitation should be equitably shared across all states.

The conference sought to establish international laws for the use of these three types of area – for fishing and the exploitation of other marine resources, for navigation and for pollu-

tion control – and all proved very difficult to negotiate. Most difficult was management of common property resources in the RCH areas: some countries, notably the United States, declined to sign a treaty that gave control over exploitation of resources there to a committee of states (on which each state would be in a minority) that would share the returns among all countries. Eventually only a very weak agreement was achieved.

The conference is a paradigmatic example of the establishment of a regime to manage resources outside the territorial control of sovereign states, and illustrates the many problems involved in negotiating agreements and then implementing them because of the threats to individual interests (such as profitability of resource exploitation).

The agreements reached divide the world's oceans into seven zones, thereby adding a major new component to the world political map:

- 1 inland waters;
- 2 territorial seas, which are twelve miles out from shore (or an agreed baseline) and considered part of a country's sovereign territory;
- 3 contiguous zones, covering a further twelve-mile-wide band, in which states can apply customs and other regulations;
- 4 continental shelves, extending 200 miles out and over which the adjacent states have exclusive rights to resources on the seabed;
- 5 fishing zones, extending 200 nautical miles out, within which adjacent states can claim exclusive rights;
- 6 exclusive economic zones, which (where defined) embrace the previous two, and
- 7 the high seas, which comprise the RCH areas.

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United Nations Conference on Trade and Development (UNCTAD)

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RON JOHNSTON

United Nations Conference on Trade and Development (UNCTAD)

The United Nations Conference on Trade and Development (UNCTAD) is both a series of conferences, normally held every four years, and a permanent organization, with headquarters in Geneva. UNCTAD has provided a forum in which developed countries (DCs) and LESS-DEVELOPED COUNTRIES (LDCs) can discuss and, to some extent, negotiate development issues. It also produces a wide range of statistical material and special studies on development. UNCTAD was a powerful influence on development thinking in the 1960s and 1970s; since then its influence has waned considerably.

UNCTAD arose out of pressure from developing countries, many of whom had just gained political independence after World War II. Developing countries believed that the international trading system did not operate in their interests. They felt too that the main international institutions – the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK – largely represented the interests of industrial countries and were excessively committed to FREE TRADE. Within UNCTAD, many proposals put forward by developing countries organized into the GROUP OF 77 (G-77) (such as those to stabilize commodity prices) have been opposed by the industrial countries.

Issues have shifted with different conferences. The first conference (UNCTAD I), held in 1964 under the Secretary-Generalship of RAUL PREBISCH, concentrated on issues of commodity policy. It established in the public mind a clear link between primary-commodity export performance and the development prospects of the THIRD WORLD. UNCTAD

popularized the idea that developing countries suffered from a long-term decline in their TERMS OF TRADE of commodities in relation to manufactures. UNCTAD also stressed that developing countries suffered from problems of access to developed-country markets for their processed commodities, arising from tariff structures which escalated with the degree of processing and from import restrictions designed to protect developed countries' own production of agricultural products like sugar and oilseeds. A major emphasis on commodities also characterized the fourth conference, UNCTAD IV, in Nairobi in 1976. Following a price boom in primary commodities in 1971–2 and the rise in oil prices brought about by the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) in 1973–4, UNCTAD introduced its proposals for the INTEGRATED PROGRAMME FOR COMMODITIES (IPC).

Another issue which has been part of the UNCTAD deliberations on commodities is compensatory financing for shortfalls in export earnings. This was introduced at the time of the IPC proposals at UNCTAD IV and again at UNCTAD VI in 1983. UNCTAD's proposals were designed to address the problem of supply fluctuations and there were plans to incorporate them into the IPC's Common Fund. The compensatory financing proposals were never implemented. The IMF's Compensatory Financing Facility (CFF) was already in place before UNCTAD I and the EUROPEAN ECONOMIC COMMUNITY (EEC) developed the STABEX scheme as an alternative to UNCTAD's proposals.

Problems of market access for developing countries' manufactured exports were addressed in UNCTAD II, held in New Delhi in 1968. Developing countries in UNCTAD called for preferential and non-reciprocal treatment of their exports, both with regard to TARIFFS and NON-TARIFF BARRIERS (NTBs). Discussions were held which laid the groundwork for the development of a GENERALISED SYSTEM OF PREFERENCES (GSP), subsequently introduced by the major industrial countries over the period 1971–6.

The activities of UNCTAD have run in parallel with those of other international organizations. Trade negotiations to reduce tariffs and NTBs have taken place within GATT – now the WORLD TRADE ORGANIZATION (WTO) – though UNCTAD was successful in taking the initiative on the GSP. Despite the failure of UNCTAD's own proposals for compensatory financing, UNCTAD did exert some influence during the 1960s on the scope of the IMF's CFF.

UNCTAD's influence has lessened with the growth of free-market policies in most industrial countries since the 1980s and the widespread introduction of such policies in developing countries as part of IMF or World Bank loan conditions (see CONDITIONALITY).

See also:

commodity agreements; commodity power; New International Economic Order (NIEO)

Further reading

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United Nations Development Programme (UNDP)

The United Nations Development Programme (UNDP) was formed by the UNITED NATIONS (UN) General Assembly in 1971 and has its headquarters in New York. Its primary function is to promote human development in the poorest countries of the world, focusing on such areas as job creation, environmental regeneration and poverty elimination. The success of the UNDP has been mixed, and mirrors the problems and difficulties associated with AID, foreign aid and the promotion of DEVELOPMENT in general. The UNDP also produces the seminal *Human Development Report*, which includes the Human Development Index (HDI) – a ranking of countries by an aggregate of life expectancy, adult literacy, education enrolments and real GROSS DOMESTIC PRODUCT (GDP) per capita. The UNDP's resident representative in any country is also usually the highest ranking UN official present: they are often delegated or mandated to coordinate the activities of other UN agencies. In 1998, the UNDP had offices located in 134 countries and worked in 174 countries.

See also:

Development Assistance Committee (DAC); sustainable development

Further reading

- UNDP (1998) *Human Development Report*, Oxford: Oxford University Press. Annual report providing a wealth of data collected by the UNDP and also insight into UNDP thinking, perspectives and the current approach to development in any given year.

JOHN THOBURN

ANDREW M. SHERRIFF

United Nations Economic Commission for Africa (ECA)

The United Nations Economic Commission for Africa (ECA) was established alongside the other regional commissions by the end of the 1950s to advance the United Nation's post-war agenda for peace and DEVELOPMENT. Unlike its counterpart in Latin America, the UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA (ECLA), the ECA was relatively unnoticed during its first couple of decades – quietly collecting economic data, training national accounts statisticians and so on. However, its preoccupation with technical minutiae changed in the mid-1970s, when Adebayo Adedeji became Executive Secretary. Over the next decade and a half, ECA seemed to inherit the mantle of ECLA, advancing counter-dependence perspectives, as encapsulated in the LAGOS PLAN OF ACTION (LPA) (Onimode and Synge, 1995). Subsequently, under K.Y. Amoako and reflective of the times, the ECA has again adopted a more orthodox orientation, focusing on partnerships with non-state actors, both NON-GOVERNMENTAL ORGANIZATIONS (NGOs) and the private sector; ECA now hosts an African centre for CIVIL SOCIETY. The subject of its fortieth-anniversary conference in mid-1998 was women and development. The ECA is intensely involved in the current UN Special Initiative, as well as myriad peacekeeping responses in association with the other pair of Pan-African inter-governmental agencies: the Organization of African Unity (OAU) and AFRICAN DEVELOPMENT BANK (AfDB). ECA is preoccupied with capacity-building and regional development. Its status is enhanced by the origin and eminence of the current UN Secretary General Kofi Annan, who reported to the Security Council in April 1998 on 'The causes of conflict and the promotion of durable peace and sustainable development in Africa'.

See also:

sub-Saharan Africa (SSA)

Reference

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TIMOTHY M. SHAW

United Nations Economic Commission for Latin America (ECLA)

The United Nations Economic Commission for Latin America (ECLA) was set up in 1948 and has its headquarters in Santiago, Chile. In the early 1980s, it changed its name to the Economic Commission for Latin America and the Caribbean (ECLAC) to reflect its geographic coverage. Under RAUL PREBISCH, its first Executive Secretary, ECLA was extremely influential in developing the Latin American structuralist approach to economic development (see STRUCTURALISM), advocating IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI), an active role for the state in the promotion of development and regional integration within Latin America. It was also a major protagonist in the debate over inflation in the region. The influence of ECLA waned with the revival of neo-classical ideas in the 1970s (see NEO-CLASSICAL ECONOMICS), but in recent years ECLAC has become an important critic of the excesses of market liberalization in Latin America, emphasizing issues of social equity.

See also:

United Nations Economic Commission for Africa (ECA)

RHYS JENKINS

**UNITED NATIONS ECONOMIC
COMMISSION FOR LATIN AMERICA
AND THE CARIBBEAN (ECLAC) *see***

United Nations Economic Commission for Latin America (ECLA)

**United Nations Educational,
Social and Cultural Organization
(UNESCO)**

The Constitution of the United Nations Education, Social and Cultural Organization (UNESCO) was signed in London on 16 November 1945 and came into force on 4 November 1946. UNESCO's purpose was to contribute to peace and security by promoting collaboration between nations through education, science and culture. The history of the creation of UNESCO encompasses two international conferences: the Conference of Allied Ministers of Education (CAME), which took place in London from November 1942 to 5 December 1945, and the Conference of the United Nations for the Establishment of an International Organization for Education and Culture, held in London from 1-16 November 1945. The original purpose of CAME was to create an agency for bringing material aid to post-war educational and cultural reconstruction that comprised all member-states of the UNITED NATIONS (UN) with the overall purpose of contributing to peace and security by promoting collaboration among the nations through education, science and culture.

UNESCO's decision-making structure is composed of the General Conference, an Executive Board and a Secretariat. The General Conference is UNESCO's supreme governing body. It consists of representatives of member-states appointed by their national governments. It determines the general policies, takes decisions on programmes and approves the budget submitted to it by the Executive Board, following the principle of one vote per country. It also elects members to the Executive Board and appoints the Director General. The Executive Board prepares the work of the

General Conference and is responsible for the execution of conference decisions by the Secretariat. The Secretariat consists of the Director General and staff, and is responsible for the implementation of the programme adopted by member-states. UNESCO's headquarters are located in Paris.

The United States withdrew its membership from UNESCO on 31 December 1984 (followed a year later by the United Kingdom and Singapore). It claimed that UNESCO had politicized virtually every subject it dealt with, had exhibited hostility towards the basic institutions of a free society (especially a free market and a free press) and had demonstrated unrestrained budgetary expansion. In the light of the removal of the US\$50 million contribution to UNESCO's programmes (which constituted 30 per cent of its total income), UNESCO has been under pressure to introduce reforms, restructure itself, modernize its internal management and reorient its programmes with the prospect of the United States (and the United Kingdom) rejoining the organization.

UNESCO's major programmes include: Towards Lifelong Education for All; The Sciences in the Service of Development; Cultural Development; Heritage and Creativity; Communication, Information and Informatics; Towards a Culture of Peace; Environment and Population, and Education and Information for Development.

Further reading

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- Sewell, J. (1975) *UNESCO and World Politics: Engaging in International Relations*, Princeton, NJ: Princeton University Press.

SONIA EL KAHAL

United Nations Environmental Programme (UNEP)

The growth and influence of INTERNATIONAL ORGANIZATIONS (IOs), such as the United Nations Environmental Programme (UNEP), and related 'regimes' is of importance in assessing changing governance structures and ideas in the global political economy. Growing concern over global environmental issues led to the creation of UNEP following the 1972 Stockholm Conference on the Human Environment. Its mandate is to coordinate, encourage and catalyse environmental action, mainly (though not only) within the UNITED NATIONS (UN) system. It consists of a governing council of fifty-eight member-governments elected on a rotating basis for four years, backed by a small secretariat based in Nairobi. One component of UNEP is the Environment Coordination Board which was set up to coordinate all UN bodies with programmes of environmental significance (for example, the FOOD AND AGRICULTURE ORGANIZATION (FAO), UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP), WORLD HEALTH ORGANIZATION (WHO) and WORLD BANK). In 1977, this component of UNEP was subsumed under the ACC (UN Committee on Coordination). One resulting development in the 1980s was 'system-wide medium-term planning' (SWMTEP) in the UN system. Another component is the Environmental Fund, which was not established to finance major environmental projects but to enable UNEP to carry out its catalytic role through information campaigns, advice, assistance, and the collection and dissemination of data: for example, its Earthwatch Programme gathers data, especially through the Global Environmental Monitoring System (GEMS), as well as managing the International Register of Potentially Toxic Chemicals (IRPTC). Each year the 'State of the environment' report is published. With the UNITED NATIONS EDUCATIONAL, SOCIAL AND CULTURAL ORGANIZATION (UNESCO), UNEP has raised consciousness of environmental issues through promoting environmental education. Its Industry and Environment Office

in Paris seeks to bring together industry, governments and NON-GOVERNMENTAL ORGANIZATIONS (NGOs) so as to promote SUSTAINABLE DEVELOPMENT. UNEP organizes meetings and conferences that are important to international environmental diplomacy – for example, in the build-up to the Montreal Protocol on substances that deplete the ozone layer (1987), the establishment of the Intergovernmental Panel on Climate Change (IPCC), the Earth Summit at Rio in 1992 (see GLOBAL WARMING (UN CLIMATE CHANGE CONVENTION)) and related conventions on climate change and biodiversity. Along with the World Bank and the UNDP, the UNEP is responsible for the Global Environmental Facility (GEF) set up in the early 1990s. This fund gives concessional support and advice for global environmental programmes relating to reduction of greenhouse gas emissions, protection of the ozone layer, conservation of biodiversity and protection of international marine and freshwater resources. In practice, the World Bank carries out most of the operation of the GEF; while UNEP lacks the funds and project expertise of the Bank, it is not as dominated by rich developed countries. The latter may favour the Bank partly because of its commitment to promoting NEO-LIBERALISM – that is, 'market-friendly' policies. Perhaps UNEP's greatest success has been in supporting the growth of environmental law, both soft law (guidelines, principles and non-binding agreements) and major international conventions and protocols. Notable examples include the Montreal Protocol, non-binding agreements on offshore mining and drilling, and various action plans, agreements, conventions and protocols relating to the management of shared water resources under the Regional Seas Programme. It has also played a part in the monitoring of compliance with international rules.

Further reading

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United Nations Industrial Development Organization (UNIDO)

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DAVID LAW

United Nations High Commissioner for Refugees (UNHCR)

The Office of the United Nations High Commissioner for Refugees (UNHCR) is the primary international agency concerned with the welfare and rights of refugees. Established by the UNITED NATIONS (UN) General Assembly, it began its operations on the 1 January 1951 with a temporary three-year mandate. First construed as a protection and coordinating non-operational agency, it did not have a budget to conduct field operations. The regular budget of the UNHCR covers administrative costs and appeals have to be launched for specific programmes and initiatives. The organization is led by a High Commissioner for Refugees, appointed by the General Assembly for a five-year term from nominations by the United Nations Secretary General. The UNHCR is also governed by the 1951 UN Convention Relating to the Status of Refugees and its 1967 protocol, which denotes the international legal protection for refugees.

As various refugee crises arose in the post-World War II era, it was seen that there was a need to extend the length of UNHCR's original mandate and to give the organization the ability to conduct field operations. However, UNHCR's dual role of protecting refugees and ensuring the observance of legal instruments has brought certain difficulties to the organization. UNHCR is an evolutionary organization that has grown and adapted to meet the perceived needs of refugees. Although it has won two Nobel Prizes, the UNHCR was hampered throughout the COLD WAR by the political dynamics of refugee problems between the SUPERPOWERS. In the immediate post-Cold War era, UNHCR grew in prominence –

operating in the former Yugoslavia and Central Africa. The UNHCR has also been in the forefront of developing relationships with INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs) and NON-GOVERNMENTAL ORGANIZATIONS (NGOs) (maintaining contact with close to 1,000 of them in the 1990s), with around a quarter of UNHCR's budget being channelled through INGOs in the 1990s.

See also:

aid

Further reading

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UNHCR (1997) *The State of the World's Refugees: A Humanitarian Agenda*, Oxford: Oxford University Press. Excellent source of facts and figures on the UNHCR and refugee issues. Produced by the UNHCR and an independent academic advisory group.

ANDREW M. SHERRIFF

United Nations Industrial Development Organization (UNIDO)

In the early 1960s a Centre for Industrial Development (CID) had been set up within the UNITED NATIONS (UN) in New York to promote industrialization in the Third World, but in 1966, as a result of pressure from LESS-DEVELOPED COUNTRIES (LDCs), the CID was replaced by the United Nations Industrial Development Organization (UNIDO) under a resolution of the UN General Assembly. Starting business in January 1967 with its headquarters in Vienna, Austria, UNIDO was intended to be the central coordinating body

for industrial activities within the UN system. In 1975, at a conference in Lima, UNIDO set an ambitious target for the share of LDCs in world manufacturing output: 25 per cent by the end of the century; at the time, UNIDO saw its role as promoting this industrialization by aiding and guiding the public sector.

However, increasingly from the late 1970s, there was strong pressure from a number of developed countries (particularly from the United Kingdom and the United States) for UNIDO to change and limit its role to one of supporting the private sector within an industrialization strategy. As a result, since the early 1990s, UNIDO has placed more emphasis on decentralized technical consultancies with a commensurate reduction in its size. In 1997, a Business Plan was approved under which UNIDO switched its focus: sectorally to agro-based industries and regionally to the LEAST-DEVELOPED COUNTRIES (LLDCs). Nevertheless, the US government grew increasingly impatient with what it saw as UNIDO's slow pace of policy reform and managerial restructuring and, arguing that UNIDO's work could be more effectively carried out by other agencies (most notably the INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK), it announced in 1995 that it would withdraw from UNIDO by the end of 1996.

Not surprisingly, UNIDO has since then faced a financial crisis, with a budget of \$130 million for the two years of 1998 and 1999 that is a fifth down on 1996 and 1997 and compares with arrears on subscriptions of \$128 million in early 1999.

Further reading

UNIDO's web site is a useful source of information. The address is <http://www.unido.org>.

CHRIS EDWARDS

United Nations Institute for Training and Research (UNITAR)

The United Nations Institute for Training and Research (UNITAR) was established in 1965 to enhance the ability of the UNITED NATIONS (UN) to produce high-quality research and to bolster the ambitions for the organization of the UN Secretary General of the day. It was also envisaged that UNITAR would organize training programmes, especially for diplomats at the UN headquarters in New York, Geneva and, later, Vienna.

Although the organization produced a large number of publications in the first fifteen years of its existence, it is now largely a training organization. In the 1980s, UNITAR helped in the establishment of new states' foreign ministries and in the development of local training institutes in the THIRD WORLD. This focus on capacity-building in Third World countries has continued and been expanded. It has also helped coordinate large-scale research and training programmes, often with other UN agencies, foreign ministries or NON-GOVERNMENTAL ORGANIZATIONS (NGOs). It developed, for example, a key focus on environmental issues in the late 1980s and, later, on conflict-management and -resolution. It now sees its vocation as helping in the establishment of more local training initiatives to ensure that there is a continuity of such provision. UNITAR has always been largely financed by voluntary donations from sympathetic states, which has left the organization in a constantly financially precarious position. Under the impact of UN budget cuts, UNITAR was extensively reorganized in the early 1990s and much reduced in size. Its headquarters are now in Geneva, where it has a permanent staff of about a dozen people. In addition, it can draw on human resources from the ranks of the international agencies and academia, using people who work for UNITAR on an occasional basis.

Further reading

Information on the UNITAR can be accessed on info@unitar.org.

ANDREW WILLIAMS

United Nations Relief and Rehabilitation Administration (UNRRA)

The United Nations Relief and Rehabilitation Administration (UNRRA) was established during World War II on 9 November 1943. The aim of the agency, as defined by its original forty-four founding nations, was to provide assistance to the people of Axis countries liberated by the Allies. The United States bore the brunt of the costs of UNRRA. In all, an estimated US\$4 billion was given in seventeen countries, in the form of millions of tons of food, goods and industrial equipment. UNRRA handed over operations to other UNITED NATIONS (UN) agencies on the 30 June 1947.

See also:

aid

ANDREW M. SHERRIFF

Universal Copyright Convention (UCC)

The Universal Copyright Convention (UCC) was adopted at a UNITED NATIONS EDUCATIONAL, SOCIAL AND CULTURAL ORGANIZATION (UNESCO) conference in Geneva in 1952 and revised in Paris in 1971. Administered by UNESCO, it formalized the use of the universal copyright symbol (©). The United States led efforts to produce the UCC, as US copyright law in this period did not permit adherence to the Berne Convention. Though weaker than Berne, the UCC gave countries unwilling or unable to ratify Berne some

measure of international protection for their national authors. However, since the United States joined Berne and (more recently) INTELLECTUAL PROPERTY RIGHTS (IPRs) came within the remit of the WORLD TRADE ORGANIZATION (WTO) through TRADE-RELATED INTELLECTUAL PROPERTY RIGHTS (TRIPs), the UCC has essentially been superseded.

CHRISTOPHER MAY

Universal Postal Union (UPU)

The Universal Postal Union (UPU) sets uniform procedures for the reciprocal exchange of international mail and for increasing the speed with which correspondence moves between countries. Established by the Treaty of Berne in 1874, the UPU was the first permanent international organization in which most of the world's governments participated. It unified conflicting national postal services and regulations into a single set of rules for international mail and ensured the principle of free transit of letters between members. It became a specialized UNITED NATIONS (UN) agency in 1947. By 1996, it had 189 members.

PAUL G. HARRIS

urban bias (UB)

Urban bias (UB) is a strategy of DEVELOPMENT that discriminates against the rural sector and favours the urban sector. It is an important subject of study in international political economy (IPE) in relation to rural poverty, unemployment and economic backwardness in LESS-DEVELOPED COUNTRIES (LDCs). UB is responsible not only for the generation and perpetuation of rural poverty, but also for an overall reduction in the tempo of development.

UB is the propensity of the urban policy-makers to favour urban areas with regard to development. This finds its expression in the matter of allocation of INVESTMENT. More and more investment is allocated to urban areas

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that do not deserve it on the grounds of economic efficiency and equity (Lipton, 1977). Allocative bias, which is a manifestation of UB, is ultimately harmful for the economy in general and the rural sector in particular.

Urban bias is inequitable in many ways. Studies have brought home the fact that rural income is more equally distributed than urban income. Thus, given the same pattern of income distribution, the equity principle demands that more of additional income should be distributed to the rural sector. However, this is precisely not done and on the contrary more income is distributed to the urban sector. This is one of the reasons for the growing sectoral inequalities in LDCs. Poverty of the rural sector is caused and aggravated by the transfer of resources from rural to urban areas through taxation, unfavourable TERMS OF TRADE against agriculture, and the drain of skills and cash from rural areas. But no equivalent compensation is paid to the rural sector for the loss of resources. Hence, poverty remains the natural outcome of such urban-biased strategies of development. Capitalist relations do not touch the rural sector in most LDCs. Therefore, the functional DUALISM continues unabated. The urban sector, which is more organized, is able to exploit the rural sector and uneven urban development continues through surplus extraction from the rural sector (Ghosh, 1990).

Reference

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B.N. GHOSH

Uruguay Round

The Uruguay Round of multilateral trade negotiations (1986–93) was the largest and

most complex international economic negotiation ever attempted. Its centrepiece was the creation of the WORLD TRADE ORGANIZATION (WTO), which completed the architecture of global economic governance first sketched at Bretton Woods and in the HAVANA CHARTER.

The Round was the eighth held under the auspices of the General Agreement on Tariffs and Trade (GATT), with each round in effect modifying and extending the existing agreements embedded in the trade regime. The first Rounds were about conventional reciprocal cuts in TARIFFS. The KENNEDY ROUND of the 1960s centred on the innovative ‘formula’ cut and the TOKYO ROUND priority was NON-TARIFF BARRIERS (NTBs). The theme of the Uruguay Round was GLOBALIZATION, understood as a change in the things that are traded and in who is trading them. The expanding domain of the global market, both functionally and geographically, challenged states anxious to maintain social control of the economy while promoting dynamic growth. For the first time in the GATT era, the DOUBLE MOVEMENT operated globally.

The Round was launched by ministers at Punta del Este, Uruguay, in September 1986: the Punta Declaration provided a negotiating agenda for the Round. Ministers reviewed progress in Montréal in December 1988 and prematurely attempted to end the Round in Brussels in December 1990. The Round concluded in December 1993 and the Final Act was signed at a ministerial meeting in Marrakech in April 1994, nearly twelve years after the first steps were taken at the GATT ministerial meeting of 1982.

The need for a new Round was apparent almost immediately after the Tokyo Round ended in 1979. DEVELOPING COUNTRIES had effectively opted out through the provisions for ‘special and differential’ treatment, by not signing the limited-membership Codes and by not ‘binding’ their tariffs. The fragmentation of rights and obligations created ambiguity and conflict as new technologies and newly dynamic countries transformed the world economy. Developed countries (DCs) responded with trade instruments beyond GATT’s reach –

the so-called 'new protectionism'. The Punta Declaration included issues left over from previous rounds (SUBSIDIES, for example), issues of interest to developing countries that had not been properly covered in the past (for example, textiles) and the 'new issues' created by economic change – trade in services, TRADE-RELATED INVESTMENT MEASURES (TRIMs) and TRADE-RELATED INTELLECTUAL PROPERTY RIGHTS (TRIPs). Much of the Round seemed to be held hostage to the old issue of agriculture as a result of the farm subsidy war of the 1980s. The agenda also included institutional matters designed to strengthen GATT by enhancing its ability to monitor trade policies and settle disputes, and by providing a greater role for ministers.

The Final Act contains over thirty agreements, understandings and declarations. The agreements include the GATT 1994, the GENERAL AGREEMENT ON TRADE IN SERVICES (GATS), the Agreement on Agriculture, a thorough reform of trade rules, provisions on TRIPs and TRIMs, and 26,000 pages of national commitments to lower tariffs and NTBs to merchandise trade. Tariff cuts were large in percentage terms, though the absolute cuts are often small because tariffs were already quite low among ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries. More important, especially for developing countries, VOLUNTARY EXPORT RESTRAINTS (VERs) were to be eliminated; the textile barriers in the MULTI-FIBRE ARRANGEMENT (MFA) would be restricted, then eliminated, over a decade; there were new definitions and rules regarding the use of subsidies and COUNTERVAILING DUTIES, and new measures to combat DUMPING.

Explanations of the process and the outcome stress domestic political economy factors and a changing international system. During the Round's dozen years, delay was attributed to an unfavourable conjuncture of elections, the power of lobbies, the effect of a rising trade deficit on the US Congress, early antipathy in key developing countries and the end of the COLD WAR. The common assumption in such claims is that exogenous 'political will' is

required to start negotiations, to conduct the bargaining and to conclude a Round. Discussions in the GROUP OF 7 (G-7), the QUADRILATERAL GROUP OF TRADE MINISTERS and in many more informal coalitions, like the Cairns Group, were certainly important, but this political process was vital not simply for bargaining about 'interests' but for discovering what was at stake. States had to learn how to negotiate in areas never or inadequately covered in the past. The role of the OECD was essential in developing the concepts used in the agriculture and services negotiations.

The institutional norms of MULTILATERALISM shaped the outcome. Participants acted in light of the General Principle in the Punta Declaration that: 'The launching, the conduct and the implementation of the outcome of the negotiations shall be treated as parts of a single undertaking.' As states came to appreciate the full complexity of globalization, they created a global ISSUE AREA linking all COMMERCIAL POLICY (CP) issues, including supposedly domestic issues. Globalization affects countries in different ways, but the Single Undertaking forced everybody's interests in the enormous negotiation to be accommodated in the Final Act, which countries could accept or reject only in its entirety. The Single Undertaking gave no state a veto, though it required the leading states to take account of the views of other significant players in a given domain. Market-access negotiations are defined by MARKET POWER; negotiations on rules, by contrast, allow a greater role for skill and perseverance. New kinds of coalitions were especially active during the early stages of the Round, though power still mattered: one crucial step in unblocking agriculture, for example, was the bilateral accord between the European Union (EU) and the United States that was concluded at Blair House in November 1992. Even the largest countries began with objectives that in the end were not met, but the Single Undertaking made it difficult for any state to evaluate the whole on the basis of one element.

Many texts reflect a broad consensus and not simply the wishes of OECD countries. As developing countries became integrated into

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the trading system, they were expected to increase the extent of their obligations and they expected to play a more active role in the negotiations. Strengthening an open and transparent system, rather than gaining exemption from its disciplines, may have been their single most important objective. The multilateral logic of the Single Undertaking makes all WTO benefits and obligations indivisibly applicable for all members. Its diffuse RECIPROCITY linked acceptance of new disciplines in such things as intellectual property to stronger disciplines on advanced economies in such areas as textiles and tropical products.

Assessments of the Final Act ask whether it will foster growth (in the world or in specific countries), allow governments to ease structural adjustment without harming efficiency, and improve governance by strengthening the ability to enforce rules and settle disputes. Economists believe the outcome will increase overall world economic welfare, meaning that income (rather than simply the volume of trade) would be higher than it might have been had the Round failed. The GATT secretariat study of the agreements on trade in goods (not services) was typical in reporting a range of possibilities for the increase in world income in 2005, depending on the assumptions used, from US\$109 billion to US\$510 billion per year. These estimates of static gains may be low, since the dynamic gains from the improved international trading environment are unquantifiable. Moreover, the actual texts frequently codify a process of policy reform that was already underway, often in anticipation of the agreements. (This kind of change is harder and therefore slower for many developing countries, however.) The ability of the regime to foster this convergence process may be more significant in its reduction of conflict and promotion of growth than any quantifiable results.

The double movement describes a dynamic

process, not a single bargain. How states understood themselves in relation to the world trading system – their identity as traders – had been shaped by the trade regime, just as states shaped the regime. The Uruguay Round success, therefore, suggests two conclusions relevant to IPE debates. First, despite the absence of an undisputed hegemon, the Round was a major effort at further, coordinated, multilateral LIBERALIZATION. Second, the WTO incorporated more issues and more actors in a new more integrated system of rules, but did it within a stable normative framework. The Final Act, in sum, should be understood as ‘norm-governed change’ within the trade regime.

See also:

Bretton Woods system; governance, global; international organizations (IOs); trade agreements; trade policy; trade regimes

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ROBERT WOLFE

V

value added tax (VAT)

Value added tax (VAT) is an indirect tax, first applied in France in 1954 and subsequently introduced in the EUROPEAN COMMUNITY (EC) (1967–73) according to the ‘origin’ principle. It is applied on value added at each stage of exchange of goods and services, proportional to the extra value added to the product or service at that stage, thus avoiding the ‘cascade effect’. It facilitates the removal of external tariffs in CUSTOMS UNIONS (CUs), FREE TRADE AREAS (FTAs) or COMMON MARKETS. VAT is increasingly popular because of its potential higher revenue yields and its effect of controlling the black economy.

RODERICK PACE

value theory

Value theory – the theory of the nature and sources of value in economic life – often appears to be a highly abstruse area of concern. However, it opens up critical analytical questions within economic theory and central issues in ethical debate about economic life.

Analytically, modern value theory has fallen into three distinctive camps. Classical economics generated the LABOUR THEORY OF VALUE, which identified human labour as the basic source of all that was valuable in economic exchanges and as the ultimate measure of the value actually attributed to goods and services within the processes of economic exchange. The classical labour theory of value was maintained and extended by KARL MARX and became the basis of classical MARXIAN ECO-

NOMICS and of the economic theories of MARXISM–LENINISM.

Contemporary mainstream economic theory, however, abandoned the labour theory of value and replaced it with a theory of the exchange value of goods or services as a function of its marginal utility to consumers and its marginal cost to producers (the utility of the last unit actually sold, expressed in terms of the price that the final consumer is prepared to pay for that unit; and the cost to producers of producing that last unit of the good or service). Within the production of goods and services, the ‘intrinsic’ value of any factor of production was also to be identified with the marginal contribution that each factor made to the production of that good or service when produced at the lowest practical cost. The value of human labour within any firm or economy, from this perspective, was thus determined by the productivity of human labour within that firm or economy relative to the productivity of other factors of production – highly productive labour giving a relatively high value to the contribution of the last unit of labour employed in the productive processes of that firm or economy, and vice-versa.

The third major approach to value theory rejects both the labour theory of value and the marginalist theory of value. The Sraffian theory of value is based on a direct criticism of the marginalist theory, arguing that the error in the marginalist account is the implicit assumption that the marginal productivity of all factors of production (including labour) is given, exogenous to the functioning of the actual economy within which production takes place. As PIERO SRAFFA sought to prove mathematically, however, the marginal productivity of each factor of production is established by the marginal

productivities of all other factors of production: attempts to explain the marginal productivity of one factor in terms of the relative marginal productivity of others collapse into a tautology (for example, the explanation of low marginal productivity of labour in terms of the high marginal productivity of capital equipment is true definitionally and actually offers, in itself, no other reason for believing this to be the case than its appearance). A similar criticism is applied to attempts to 'explain' the relative productivities of the various factors of production in terms of their relative abundance or scarcity within any economy. Sraffa's conclusion was that the relative productivities (and/or abundance/scarcity) of the various factors of production within any economy were ultimately the product of the historical development and current condition of that economy, including its political and social institutions; a condition that was inherently, if not readily, alterable by policy and action. Thus an apparent abundance of labour within an economy was more to do with such factors as social norms, legal frameworks (such that, for example, child labour is tolerated), the acceptance of paid female labour outside the home and/or the lack of retirement provisions: any of these could create a greater apparent availability of labour than in societies lacking any, or all, of these norms and practices. An abundance of cheap labour would, in turn, encourage labour-intensive modes of production, discourage the accumulation and application of industrial capital, and therefore produce a society that seemed to have an abundance of low productive labour and an apparent scarcity of industrial capital.

The ethical and political implications of these three contrasting approaches to value theory have been profound. The labour theory of value, in its Marxist guise, underpinned the ethical rejection of a capitalist society that appeared to expropriate a significant portion of the value that had been created by those whose labour actually generated the goods and services produced and exchanged within the marketplace. Such a rejection played a critical role in the political agenda for the overthrow of

CAPITALISM and its replacement by SOCIALISM and/or COMMUNISM.

The marginalist approach appeared to relegate value to a technical issue that should be determined impersonally by the functioning of the market system. If relative abundance/scarcity and/or productivity determined the value (and hence the financial reward) to labour and capital, there would be little point in ethical discussion or, ultimately, political programmes to modify or even overturn market valuation of goods, services and their factors of production.

The Sraffian approach, however, returned the issue of value to the ethical and political domain by emphasizing the contextual determination of relative abundances/scarcities, productivity and hence relative financial rewards. Poverty wages could, again, be criticized ethically and appropriate programmes of action initiated within the political system to enhance labour productivity and incomes.

Value theory, for all its abstruse characteristics, thus continues to resonate within the continuing debates about the functioning, ethical qualities and prospects for the constructive modification of the contemporary economy.

See also:

neo-Ricardian (post-Sraffian) theory; Sraffian economics

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R.J. BARRY JONES

Veblen, Thorstein Bunde (1857–1929)

Thorstein Veblen is considered the founder (along with John R. Commons) of American

institutional economics, sometimes referred to as 'evolutionary economics'. Veblen was a radical critic of the NEO-CLASSICAL ECONOMICS of his day and also a radical critic of his society. His views were iconoclastic, his writing style sardonic, witty and satirical.

Veblen was born to Norwegian immigrant parents. His parents were successful and affluent farmers who valued education highly. Veblen attended Carleton College in Minnesota, where he received a bachelor's degree and studied economics with John Bates Clark. He attended the Johns Hopkins University, where he attended lectures by Charles Pierce. He then attended Yale University, receiving a Ph.D. in Philosophy in 1884 – his now lost dissertation is thought to have been an examination of the ideas of Herbert Spencer and IMMANUEL KANT. At Yale, Veblen studied with William Graham Sumner and Noah Porter. In 1891, after several years of failing to find a teaching position, Veblen went to Cornell University, where he received financial support to study economics. After a year at Cornell, he left with Professor J. Lawrence Laughlin to become one of the first faculty members at the University of Chicago. At Chicago, Veblen edited the *Journal of Political Economy*. His academic career was disrupted by rumours regarding his personal life, which caused him to leave the University of Chicago in 1905. He then taught at Stanford University, the University of Missouri and the New School for Social Research.

While at Chicago (1892–1905) Veblen produced a large number of articles on a variety of subjects; the most important of these articles are his critical analyses of the emerging neo-classical economics that are collected in an edited volume entitled *The Place of Science in Modern Civilization* (1919). The most famous of Veblen's critical essays is 'Why economics is not an evolutionary science', in which Veblen argued that economics should follow the lead of the evolutionary sciences and provide a genetic account, employing cumulative causation, to explain the evolution of 'cultural institutions' – by which he meant social norms, habits of thought and habits of behaviour that organize and structure the socioeconomic

behaviour of people. In Veblen's two articles on 'The nature of capital', he argued that CAPITAL – that which genuinely makes a society productive – is the common stock of matter-of-fact knowledge regarding how to do things. The common stock of knowledge is collectively held in the minds, practices and social institutions of society. It is this common stock of knowledge that vested interests appropriated and turned to their own account. In CAPITALISM, those vested interests are the absentee owners of private property.

Veblen also had a constructive theoretical programme that combined his evolutionary approach with careful historico-cultural analysis. During his time at the University of Chicago, Veblen published his most famous book, *The Theory of the Leisure Class* (1899). This book was propelled to prominence by the appearance of two important review articles by William Dean Howells, the dean of American letters, in the journal *Literature* (1899). Though largely overlooked and misunderstood by economists, *The Theory of the Leisure Class* contains an alternative theory of consumption and Veblen's theory of institutional change. According to Veblen, people's consumption is motivated by pecuniary emulation – the desire to consume appropriately for their social reference group, which is largely determined by income. The role of the leisure class, as it has evolved, is to engage in conspicuous leisure and conspicuous consumption to show their exemption from productive work. Those whose income is not sufficient to engage in this wasteful consumption, will consume the socially appropriate goods and engage in the socially appropriate activities, according to the pecuniary standards of decency for their reference group in the status hierarchy.

The dynamics of the system are a consequence of the ever increasing productivity of the modern industrial economy. As the level of production of goods increases, prices for all goods decrease – including very expensive, formerly exclusive, status goods. Thus those goods and practices that formerly distinguished the leisure class from the common folk become available to those below them in the status hierarchy. Since the

goods are considered to be superior (and may or may not actually be more serviceable) those below the leisure class begin to consume them and thus these goods lose their function of differentiating one group from another. The leisure class then finds new pursuits or goods to distinguish themselves. The system of maintaining status creates a society that constantly requires ever increasing, but rather trivial, consumption to maintain its status system. Veblen noted that the role of women in society was to engage in conspicuous consumption and leisure on behalf of the male head of household in order to maintain his status, often to the detriment of the women so engaged.

Veblen furthered his reconstruction of economic theory along these evolutionary and cultural lines in subsequent work. *The Theory of Business Enterprise* (1906) is a theory of the firm, finance and business fluctuations. Veblen argued that, as capitalism developed, firms in the system became tightly interconnected and interdependent because of the standardizing character of the machine process. He noted that this interconnectedness made firms dependent on one another and that managing the interstices of the system became an important element of firm activity, along with the production of goods and services. The interstices of the system are where the economic system is susceptible to breaking down. Consequently, an important element of the system is the restoration of the flows of goods and services between firms when these flows are disrupted. This activity can be highly profitable. Veblen saw the growth of complexity in the system leading to specialization within the firm between those whose function is to make goods and those whose function it is to keep the system working profitably. He differentiated these as making goods and services (industry) and making money (business). He noted that it was not too long before those with sharp business sense discovered that money could be made by disrupting the overall system, then offering to overcome the disruption for a fee. Thus Veblen provided an economic theory of profitable sabotage, noting that all of the interstices offered such opportunities for those

with an eye to the main chance. Veblen also argued that the use of loan credit leads to financial fragility and increased monopolization. He argued that loan credit results in the capitalization of firms based on intangible assets such as goodwill, product differentiation, advertising and marketing, or monopoly power. Firms capitalized on this basis are unsustainable when profits inevitably decline, as the physical appliances of production become technologically obsolete. Veblen indicated that capitalism lacked a mechanism for dealing with the collapse of firms capitalized in this way, because bankruptcy and liquidation were socially disreputable.

Veblen considered *The Instinct of Workmanship and the State of the Industrial Arts* (1914) to be his most important book. In this book, Veblen rejected associationist psychology and instead explores the role of instincts in motivating human behaviour and production. Veblen argued that there are four instincts of relevance to the economic order: the predatory instinct, the parental bent, idle curiosity and the instinct of workmanship. Veblen was cautious about his use of the instinct concept, indicating that the biological character of instincts only provided the motive to a particular end; whether it was (respectively) predatory behaviour, caring for children, curiosity or taking pains to do something correctly, the means to these 'generic ends of the life process' were always cultural constructions. In this book more than any other, Veblen connected individual motivation and activity with the construction of cultural processes through which people provision themselves. Here his anthropological interests came into the foreground as he explored production and provisioning in predatory, handicraft and machine-based production systems.

In his book *Imperial Germany and the Industrial Revolution* (1915), Veblen explored the benefits of borrowing technology and the penalty for taking the lead in the development of technology in the process of economic development. He did this through the use of extended case studies of these processes using the example of the United Kingdom and Imperial Germany.

He noted the fact that borrowed technology does not require the simultaneous borrowing of the cultural institutions that developed concurrently within the culture that originally developed the technology. In *An Inquiry into the Nature of Peace* (1917), Veblen explored the cultural capacity of the modern industrial state to wage war and achieve armistice through a combination of efficient production and the encouragement of patriotic sentiments in the population. But the bellicosity that patriotism encouraged made the state incapable of perpetuating peace. He also noted that imperial ambitions combined with modern industrial technology in the cases of post-World War I Germany and Japan would inevitably lead them to creating a major disturbance of the peace. Veblen analysed the cultural institutions of absentee ownership and property rights in his book *Absentee Ownership* (1923). In *The Higher Learning in America* (1918), Veblen analysed the impact of business culture on higher education, especially the transformation of the university from a centre of disinterested scholarly enquiry into an instrument for producing a trained labour force and subsidizing commercially important research. In addition, Veblen was a frequent contributor to a popular periodical titled *The Dial*. His essays for that journal were collected in two volumes entitled *The Vested Interest and the Common Man* and *The Price System and the Engineers*.

Veblen's emphasis on evolution and culture differentiated him from his contemporaries. He employed the concept of evolution metaphorically. He was interested in understanding the working of economies through their life history, where current behaviour was a function of the evolution of cultural institutions. Cultural institutions evolved in response to changed environmental circumstances, technological innovations and invention, cultural diffusion and borrowing, intentional human behaviour of both an individual and a collective character, and pragmatically in response to problematic circumstances or serendipitously. The process of CHANGE was cumulative and circular. There was no direction to social change; progress (however defined) was no more likely than

blind drift. There were no ameliorative or automatic corrective tendencies in the economy or society. Veblen clearly thought individual behaviour and human biology were constitutive of economic behaviour, but always mediated through and given structure and form by cultural institutions.

Methodologically, Veblen's enquiry was value-laden, though couched in the objectivist language of his day – sometimes seriously, other times satirically. Since all enquiry was culturally situated and contextual for Veblen, he dismissed the natural law conceptions prevalent in neo-classical economics. Veblen's method usually involved constructing categories, derived from the context of the activity under analysis, into which he analytically separated aspects of behaviour into those that promoted the provisioning of the life process and those that supported vested interests against the commonweal. With regard to consumption he contrasted serviceability of goods and services with their use for emulatory purposes. In the case of business enterprise, he contrasted industry (making goods and services) with business (making profits). In institutional economics, this is often referred to as the 'Veblenian dichotomy'. These categories were particular to the context Veblen analysed. He made no general claims for these categories' efficacy. His approach was historical and anthropological, reflecting his understanding of the concept of culture. His own theoretical work is based on careful analysis of specific case studies, making him a precursor of today's critical cultural studies approach to social enquiry.

Veblen's work is the foundation for much current scholarship in institutional economics and remains influential in sociology. He added a number of new terms to the social science lexicon, including 'pecuniary emulation' and 'conspicuous consumption'. His institutional approach to economics has influenced the work of Wesley Clair Mitchell, JOHN KENNETH GALBRAITH, C. Wright Mills, K. William Kapp and GUNNAR MYRDAL. Contemporary institutionalists working in the tradition of Veblen include William Dugger, Warren Samuels, Marc Tool, J. Ron Stanfield, Philip

vertical integration

Mirowski and Geoffrey Hodgson (see INSTITUTIONALISM).

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WILLIAM WALLER

vertical integration

'Vertical integration' exists when a MULTINATIONAL CORPORATION (MNC) locates different stages in the production and marketing of a single product or group of products in different countries. One of the best examples of vertical integration is the petroleum industry, where oil companies are typically involved in all stages of production: namely, oil-drilling and extraction, transportation, oil-refining and distribution. Many oil companies also hold investments further downstream, producing

oil-derivatives or so-called 'petrochemicals' that are widely used in the production of other chemical products.

In essence, a vertically integrated MNC replaces arm's-length markets for raw materials and INTERMEDIATE GOODS with internalized markets. The theoretical explanation generally given for this is that there exist market imperfections which render the use of internalized markets more efficient. On the other hand, internalized markets involve certain costs of coordination and differences in the optimum scale of production at different stages which do not arise if external markets are used. RISK is also increased if vertical integration requires investment in politically unfriendly or unstable countries. Only if the efficiency gains from vertical integration exceed these costs will vertical integration be worthwhile.

See also:

petrochemical industry

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NIGEL GRIMWADE

Viner, Jacob (1892–1970)

In the view of his friend Lord Robbins, Jacob Viner is the outstanding all-rounder of twentieth-century economics, having made important contributions to international TRADE THEORY, commercial policy analysis and, above all, the history of economic thought.

Along with JOSEPH SCHUMPETER, Viner is this century's leading historian of economic thought. In this area, his methodology (much like that of ADAM SMITH) relates 'technical' economic analysis to wider intellectual currents and their 'fit' with political and legal institutions. One main strand of Viner's intellectual

history is his interpretation of the genesis of LAISSEZ-FAIRE and economic LIBERALISM, and their establishment by Smith and later English classical economists. Like Robbins, Viner forcefully counters the assertion that Smithian political economy is rooted in assumptions of a narrow utilitarian RATIONALITY, a harmony-of-interests doctrine and a nightwatchman state. The other main strand of Viner's intellectual history is the evolution of trade-and-payments theory from mercantilist times to the mid-twentieth century (see MERCANTILISM).

Viner's own contributions to trade theory and policy analysis, while mostly fitting in with NEO-CLASSICAL ECONOMICS, take their primary inspiration from classical political economy. Like Adam Smith, Viner constantly emphasizes realistic assumptions of actor behaviour and market processes in order to maintain the relevance of theory to changing problems of real-world policy. Right through his career as an economist, he pragmatically defended the classical predilection in favour of free-ish markets and small-ish government, in both domestic and international economic relations.

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RAZEEN SALLY

visible balance

A country's 'visible balance' is the overall balance of exports and imports in its trade in physical goods and merchandise: raw materials, energy sources, components, industrial equipment and finished consumer goods. It excludes those services that are traded internationally. It also excludes international transactions that are purely financial.

See also:

balance of payments

R.J. BARRY JONES

volatility

'Volatility' refers to instability in key prices such as interest rates, exchange rates, and asset and commodity prices (see COMMODITIES; EXCHANGE RATE; INTEREST RATES). Volatility is generally associated with higher levels of CAPITAL MOBILITY and SPECULATION, in that short-term movements of money (not simply economic fundamentals) determine prices. Since the end of the Bretton Woods monetary order in the early 1970s (see BRETTON WOODS SYSTEM), capital mobility and price volatility have increased substantially. By making long-term planning more difficult, increased volatility has generated demand for risk-management instruments such as DERIVATIVES.

See also:

casino capitalism

ADAM HARMES

Volcker shock

Paul Volcker – as chairman of the US central bank, the Federal Reserve Board – sharply

voluntary export restraints (VERs)

increased US short-term INTEREST RATES in 1979–81, administering a deflationary shock to the world economy that had epoch-making consequences.

Volcker's immediate concern was to reduce US INFLATION in the aftermath of the second ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) 'oil price shock'. At this time, the US dollar was weak and the US government had taken the extraordinary step of raising loans on the world capital market by issuing 'Carter bonds', denominated not in dollars but in foreign currency. For most other countries, incurring debts in foreign currency (mainly dollars) was normal and had grown enormously in recent years. However, for the United States, with the power to create more of the world's leading reserve currency, such borrowing was a sign of declining confidence in the dollar, linked to fears about US inflation. One pillar of US hegemony was at risk (see HEGEMONY, US).

The 'Volcker shock' marked a shift in US monetary policy towards prioritizing the fight against inflation. Volcker succeeded in restoring US monetary CREDIBILITY. Inflation declined. There were no more Carter bonds, even though US government-borrowing rose dramatically. The restored strength of the dollar went with a huge inflow of foreign funds into US bonds and a corresponding weakness for many other currencies, especially those of DEVELOPING COUNTRIES, who found themselves having to pay higher interest rates on their dollar-denominated debts, thus contributing (along with world recession) to the DEBT CRISIS. The Volcker shock had revived the STRUCTURAL POWER of the United States. Furthermore, it did this in a way (by making capital scarce and expensive) that served the long-term interests of the owners and controllers of mobile capital. Such interests were favoured by the Reagan administration that gained office soon after the shock, which had reduced President Carter's popularity. The (global and US) power of the Chairman of the Federal Reserve was highlighted: Volcker had initiated a historic turning point.

See also:

Braudel, Fernand: Federal Reserve System; liberalization

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DAVID LAW

voluntary export restraints (VERs)

Voluntary export restraints (VERs) serve to restrict trade between two countries through export QUOTAS imposed by the exporting country on local companies' exports. The decision to impose export quotas typically follows protracted negotiations with the importing country. VERs are voluntary in the sense that they are the most attractive of unattractive trade-restricting options faced by the exporting country.

Importing countries have used VERs to get around the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) – now the WORLD TRADE ORGANIZATION (WTO) – prohibitions on restriction of trade through TARIFF increases and import quotas. In an effort to prop up their flagging domestic companies, governments exert pressure on exporting countries to 'voluntarily' restrict their exports on a bilateral basis. The importing country's government typically initiates these negotiations in response to political pressure from companies struggling to compete with imports. Countries have used VERs to resolve trade disputes that result from escape-clause, anti-dumping and subsidy-countervailing-duty cases, as well as from threats of trade protection that have no legal standing under the GATT.

Exporting countries enjoy several benefits from their use of VERs. First, the resolution of a trade conflict through the use of VERs often helps to keep the particular conflict out of GATT. By resolving a trade dispute outside GATT, countries do not have to take on the risk that the conflict might escalate and threaten the stability of the global trading system. Second, exporting countries' governments typically prefer VERs to alternative forms of import protection (for example, tariff increases or quotas), because their domestic companies keep any excess profits resulting from the reduction in the quantity of products shipped. The use of VERs to restrict exports on a per unit rather than on a US dollar basis also provides exporting companies with the strategic flexibility to shift its exports to higher margin products to increase their profitability.

The US and Japanese governments negotiated one of the most significant VERs in 1981, when the Japanese government agreed to limit automobile exports to 1.68 million units. The Reagan administration negotiated this agreement following the failure of the Ford Motor Company and the United Auto Workers' Union to demonstrate in a US International Trade Commission escape-clause hearing that Japanese imports had been a significant cause of injury to the industry. The governments of both countries allowed the automobile VER to lapse in 1994. By then, the VER no longer limited Japanese exports due to the combination of yen appreciation and US automobile companies' product and process improvements. Several Japanese automobile producers had also established US production sites to ensure their access to the US market, which served to further reduce the effectiveness of the VERs in insulating US producers from Japanese competition.

In the URUGUAY ROUND trade negotiations (1986–94), GATT members agreed to regulate the use of VERs by including them for the first time in the GATT safeguard provisions. The Uruguay Round agreements mandated that any safeguard action (such as VERs) that was put in place in the wake of an affirmative escape-clause petition could be maintained no

longer than eight years. They would also have to be steadily liberalized over their lifetime and implemented on a multilateral rather than bilateral basis. Beginning on 1 January 1995, member-countries agreed to begin converting existing VERs to tariffs and to reduce those tariffs over a four-year period.

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STEFANIE LENWAY

voluntary restraint agreements (VRAs)

The term 'voluntary restraint agreements' (VRAs) refers to VOLUNTARY EXPORT RESTRAINTS (VERs) from the perspective of the importing rather than the exporting country. Countries have used VRAs to restrict trade in industries such as textiles and apparel, agriculture, steel, automobiles and semiconductors. During the URUGUAY ROUND of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) negotiations, member-countries agreed to regulate the future use of VRAs and to increase the stringency of the criteria adopted by countries to justify their use. This agreement to reduce the use of VRAs to regulate trade in agriculture, as well as in textiles and apparel, was a major achievement of the Uruguay Round negotiations.

See also:

World Trade Organization (WTO)

STEFANIE LENWAY

vulnerability, economic

'Economic vulnerability' refers to the potential impact of global markets on national economic and military security (see SECURITY, ECONOMIC; SECURITY, POLITICO-MILITARY). States make themselves vulnerable, the argument runs, when they trade with military rivals, *potential* rivals and potential economic competitors, who can quickly translate economic strength into military power, political influence and market dominance. The GULF WAR of 1991, for example, revealed that Western nations had made themselves vulnerable when they sold Iraq much of its army's high technology – subsequently used in the invasion of Kuwait and in the war against the United States and its allies.

Because open trade renders them vulnerable, states often construct policies to control the export of their high technologies and limit their economic dependence on military rivals and economic competitors. They implement policies that expand their own industrial and military power, reduce the military and industrial power of others, and reduce their economic and military dependence on others. The United States, for example, attempts to reduce its vulnerabilities through export-control laws that prevent the export of DUAL-USE TECHNOLOGIES – that is, commercial technologies with a key military use.

The definition and indicators of economic vulnerability, however, have been the subject of intense controversy, both among policy-makers and among scholars of international political economy (IPE). Liberal theories of political economy (see LIBERALISM) assert that trade theoretically enhances the capabilities of all trading partners and facilitates a DIVISION OF LABOUR in which mutual dependencies thrive. Export control and protectionist policies,

intended to reduce vulnerability in international economic relations, rub against the imperatives of the marketplace, and high-technology export controls can even reduce a state's innovative capability by sheltering its technology base from international competition. Neo-realist international relations (IR) theory (see NEO-REALISM), however, claims that relative gains in the international political economy are more important than mutual gains and that states must consolidate their control over markets in order to reduce their vulnerabilities and thus protect their relative economic power-base. The control of technology exports and the reduction of DEPENDENCE on others is necessary to achieve this end.

See also:

competition, economic role of; economic realism; interdependence, asymmetrical; sanctions, economic; national security state; re-exports

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BEVERLY CRAWFORD

W

wage controls

Wage controls (incomes policies) have been a pervasive feature of economic policy in many countries. Such direct government intervention in wage-setting has been used as a device for controlling INFLATION in many countries that, in other respects, can be characterized as market economies or in transition to the market economy. This article briefly reviews the rationale for and experience with wage controls in three settings: industrialized countries experiencing moderate inflation; as an element of heterodox stabilization plans in high-inflation economies; and in transition economies. It then discusses some general issues related to their design, coverage and enforcement.

Most industrialized countries used some form of wage control for parts of the post-World War II period. For instance, in the United States, controls were imposed during the Korean War (1950–2), with a wage-price freeze in 1951; voluntary wage and price ‘Guideposts’ were introduced during 1962–8; the 1971–4 ‘New Economic Policy’ established wage controls, starting with a ninety-day freeze, and voluntary ‘Pay and Price Standards’ were established during 1978–81. In the United Kingdom, controls were introduced in 1948 and lasted for three years, and from 1961 to 1979 some form of wage control was in place most of the time. Most other ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries adopted some kind of controls for extended periods of time.

Since they entail limiting wage increases directly, rather than restraining demand, the use of wage controls as an anti-inflationary

device has often been motivated by a cost-push view of inflation, according to which prices are explained primarily by movements in costs. The cost-push view was generally accompanied by the view that labour unions exercise substantial monopoly power, sometimes accompanied by the view that exceptionally rapid wage increases were primarily a reflection of TRADE UNION militancy. Wage controls fell out of favour with many professional economists during the later 1970s and 1980s, partly as a result of the experience of persistent inflation despite these controls. There was also growing awareness of the limitations of the cost-push analysis of inflation (except as a characterization of short-run developments) and increased attention was paid to the role of market forces in determining wages. In addition, research in labour economics drew attention to the role of wages in providing appropriate incentives for the supply of labour, effort and investment in human capital, and discouraged direct government intervention in wage setting.

Wage controls have also been advocated for rather different reasons as an element of heterodox stabilization programmes in high-inflation countries. Heterodox programmes seek to bring about rapid reduction in the rate of inflation by combining orthodox policies – tight FISCAL POLICY and a FIXED EXCHANGE RATE – with wage controls (and in some cases also price controls). Some examples of heterodox programmes include the Israeli stabilization programme of 1985 and the Mexican *Pacto di Solidaridad* of 1987–8. Heterodox programmes are intended to address the situation in which high inflation has become entrenched due to expectations as well as institutional rigidities in labour markets (including staggered contracts and backward

indexation). In this context, wage controls are used essentially as a coordinating device to reach a lower-inflation equilibrium. If the strategy is successful, it may reduce the initial costs of reductions in the rate of inflation. However, in most cases, the issue is one of sustaining low inflation after the initial abrupt disinflation: in a heterodox programme, the wage controls play only a temporary role of breaking inflationary inertia, while tight monetary and fiscal policies are needed to prevent a resurgence of high inflation. Controls may also aid in implementing tight monetary and fiscal policies, including by the increase of money demand and (in some cases) by providing political leverage for tough fiscal measures.

Stabilization programmes in transition economies in Central and Eastern Europe in the early 1990s also typically enforced wage controls. In high-inflation countries (for example, Poland), their rationale was in part that of a heterodox programme. In countries at an early stage of transition, there was also the view that some kind of control was needed in the absence of functioning labour markets to replace the centralized fixing of wages and prices associated with central planning (see *COMMAND ECONOMIES*). In addition, in some transition economies there was concern over the 'absent owner problem' in large *STATE-OWNED ENTERPRISES* (SOEs), where insiders including workers, managers and other stakeholders may dominate decision-making; the concern was that workers, through high wages, could appropriate enterprise profits that should have accrued to the state, resulting in a deterioration of the fiscal balance that could necessitate money creation which would lead to inflation. In this setting, wage controls are seen as a longer-lived feature of the system, which might need to continue until adequately functioning labour markets and some minimal standard of corporate governance have been established.

The international experience with wage controls has been mixed. A key lesson has been that wage controls can only be successful if supported by consistent monetary and fiscal policies. Micro-economic distortions resulting

from direct government involvement in setting wages, as well as actions taken to circumvent the controls, are also likely to be compounded the longer the wage controls are maintained.

All commonly used designs of wage controls leave some scope for avoidance. One form of wage controls is a freeze on wage rates (or more generally setting a maximum increase in wage rates). In this case, wage drift may still raise actual earnings by more than the allowed maximum and may be accelerated by reclassification of workers across pay categories, improved non-wage benefits and overtime pay. A second kind of limit, used in some transition economies (of which Poland was an example), entails restrictions on the wage bill or the average wage of the individual firm; a ceiling on the wage bill leaves the firm free to raise wages further by reducing its workforce, while a ceiling on the average wage can be avoided by hiring more lower-paid workers to bring down the average.

Another aspect of wage controls is their coverage. In some cases, for instance, controls have been limited to firms above a certain size in order to reduce the cost of administering the controls or because the need for wage controls is associated with monopoly power in larger companies. While these considerations are valid, limiting the scope of coverage can create distortions in relative wages and create an incentive to shift employment outside the controlled sector.

Another issue is the enforcement of wage controls. In some cases, controls have been voluntary, which limits their effectiveness unless labour market conditions make them redundant. In other cases, controls have been imposed by law, with violations punishable by fines or imprisonment. Another alternative is a tax-based incomes policy, in either of two forms: either (1) workers receiving higher-than-authorized wages are required to pay a special tax on the excess or (2) a firm paying higher-than-authorized wages is subject to a special tax. The tax on the individual may be difficult to administer. At the level of the firm, it heightens the cost of paying higher wages, but does not make this cost prohibitive; this

has the advantage of greater flexibility in response to market forces. However, this approach may be problematic in transition economies – where tax-based incomes policies have been used extensively – as some enterprises are in financial difficulties. In this case, the tax may ultimately fall not on the enterprise, but on its creditors. Indeed, the case in which the companies are most likely to be indifferent to the excess-wage tax is precisely that in which controls are most needed: where corporate governance is deficient, especially if the enterprise's net worth is negative.

Further reading

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TIMOTHY D. LANE

wages

The term 'wage' refers to the remuneration an employer must pay to labour for its work. Apart from money, wage earners may also receive additional compensations in money or kind, such as healthcare or cafeteria service. The 'wage rate' is the stipulated payment per hour or day, whereas the term 'wage' on its own

refers to payment for a week's or month's labour.

A 'nominal wage' is the money labour receives, while the 'real wage' aims to describe the amount of goods and services a nominal wage can purchase. Real wages are usually presented in monetary units corresponding to a base year, arrived at through dividing nominal wages by an index (usually the consumer price index) that attempts to reflect the price of the goods consumed by the worker. If, for instance, the average nominal wage in rupiahs per week in Indonesia from 1990 to 2000 is divided by the consumer price index based on the year 2000, the resulting wage will be in rupiahs of the year 2000. If the nominal weekly wage in Indonesia were to correspond to 79,000 rupiahs in the year 2000 and a real weekly wage of 86,900 rupiahs in 1998, this would imply that a wage's purchasing power had fallen by 9 per cent between 1998 and 2000.

Different wage theories have a different and sometimes clearly opposed explanations of wage levels. Classical economists considered the wage rate to be fixed at a subsistence level – labour's natural price according to DAVID RICARDO – and because of the differences between the supply of and demand for labour, the nominal wage fluctuated around the natural wage rate. This is the 'iron law of wages'. If wages increased beyond their natural level, workers would reproduce and there would be a surplus of workers that would make wages drop back to their natural level. When wages were below their natural price, the number of workers would fall since some of them would not be able to cover their subsistence and that would make wages increase until they reached their natural price.

KARL MARX criticized the capitalist system and stated that although it was a society based on EXPLOITATION, like slave-owning or feudal societies, the wage relation concealed this fact. In a slave-owning system, the slave obviously is not compensated for a large part of their work time; the slave's master owns part of the slave's labour time. In CAPITALISM, a worker spends a certain number of hours working and receives a payment in money. It seems like a commercial

transaction like any other in which goods are exchanged for an amount of money representing their value. Behind this apparent exchange of equivalents lies the fact that the amount of time the workers devote to producing the goods they can buy is far less than their overall labouring time. The capitalists, just like the feudal lords and slave masters, take ownership of the additional part of the workers' labour time. Marx stated that wages need not be fixed at a subsistence level, but rather could be increased with productivity so long as they did not hinder capitalist expansion. Wages include a characteristic part of society's culture and productivity level. Thus, from Marx's point of view, a ticket to a football match would be a wage good in Latin America, whereas a car would be a wage good in the United States. Marx rejected the Malthusian idea that POPULATION GROWTH was essential in order to be able to reduce wages. If wages were to increase more than the growth of productivity, profitability would be reduced, ECONOMIC GROWTH would decrease and the number of jobs would therefore drop until wages and profitability reached levels suitable for capitalist expansion. For Marx, the wage rate was a variable that depended on the rate of capitalist expansion. His explanation included capitalism's need for unemployed people or people employed in such precarious conditions that they would be willing to go wherever and do whatever the rate of capitalist growth required, referring to this group of workers as the industrial 'reserve army'. Marx thought the industrial reserve army was essential for wage regulation and not the result of excessively high wages.

Neo-classical theory states that when the market works efficiently, workers receive wages that reflect labour's contribution to aggregated production – just as capitalists receive an income equivalent to capital's contribution to production. Besides, under these circumstances, full use is made of the existing means of production and there is no involuntary unemployment. Enterprises have a large number of possible labour-capital combinations that they can revert to in order to maximize their profits in agreement with the price of

these two factors in the form of wage rates and interest rates. NEO-CLASSICAL ECONOMICS considers prices not to be determined by individual firms: the individual firms are rather 'price takers'. The enterprise will therefore hire workers until the increase in productivity derived from including additional workers (that is, marginal labour productivity) equals the wage rate (due to the increased cost of the wages the additional workers will receive).

From neo-classical theory it can be deduced that although collective contracts favour the workers directly subscribing to them, they act to the detriment of the average worker. The same argument is applied to labour laws: laws that fix minimum wage levels bring about unemployment. Any interference with market mechanisms prevents both workers and capitalists from receiving the part of the product that corresponds to their contribution and such interference may have the opposite effect to what was originally intended.

From neo-classical theory the tendency to create wage uniformity for work demanding similar training in different regions or countries can also be deduced.

The continued existence of unemployment in countries with weak TRADE UNIONS or the persistence of wage differences between workers from different countries, poses problems for the neo-classical wage theory. This has given birth to new developments, such as 'efficiency wages theory'. As an example, according to this theory, if an enterprise does not adhere to the wages established by the market but instead increases them, and this increase leads to an improvement in its workers' motivation and a subsequent increase in profits, the effects of that behaviour would be analogous to those of a strong workers' union.

Most people's source of income comes from their wages, which is why we must look toward the future for answers to the problems we now have in understanding them.

See also:

labour theory of value; subsistence wages; unemployment, natural rate of; wage controls

Further reading

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B. GLORIA MARTÍNEZ GONZÁLEZ

Wallerstein, Immanuel (1930–)

Immanuel Wallerstein is the sociologist who invented world-systems analysis (see **WORLD-SYSTEMS THEORY**). As such, he has had an important influence on a wide range of disciplines (Hall, 1996). The prime target of his invention is the artificial boundary which separates history from the social sciences in contemporary scholarship. The concept of historical system is his tool to that end. This is derived from asking the question: What entity is it that changes in the social scientist's ubiquitous quest to understand 'social change'? Whereas both historians and social scientists have conventionally taken it for granted that 'national societies' are the basic units of change, Wallerstein postulates a larger entity which privileges material linkages between presumed autonomous 'societies'. He calls these entities 'historical systems' to show that they have a logic and order (that is, they are systemic), but they are constantly evolving and are not eternal (that is, they have a history) in that the practical domination of their logic has a beginning, a development and an ending. Having eliminated all rival historical systems, there is currently just a single modern world-system whose prime logic is ceaseless capital accumulation, hence its alternative name: 'capitalist world-economy'. Wallerstein's oeuvre is about understanding the beginning, development and future demise of this historical system.

Wallerstein's intellectual journey to the creation of world-systems analysis began at the premier sociology department in the United States, at Columbia University, where he

progressed from undergraduate to associate professor from the 1950s through to the late 1960s. His Ph.D. dissertation was on the politics of African independence and, in the 1960s, Wallerstein wrote and edited several books on African politics. Although he had begun to establish himself as a leading Africanist in US academia during this period, he was to come to the conclusion that the mainstream sociological tools he had been trained to use were totally inadequate for understanding what was happening in Africa (Ragin and Chirot, 1984). The social-science focus on measuring the process of modernization for comparative studies between 'developing national societies' located explanations of Africa's post-independence travails firmly within the African states themselves. Wallerstein's search for a deeper and more progressive explanation led him to expand the scope of analysis in both time and space. He spent 1970–1 at Stanford University's Center for Advanced Study in the Behavioral Sciences, where he was able to transmute from Africanist to world-systems analyst by writing of the origins of the modern world-system in Europe during the 'long sixteenth century' (c. 1450–1650). The result (Wallerstein, 1974a) was published to acclaim and criticism, establishing Wallerstein as both a major interpreter of world history and an important revisionist social theorist. Although superficially a massive change in research focus, in reality the move was entirely consistent with Wallerstein's misgivings over the treatment of Africa in the social sciences. To understand the latter's position in the late twentieth century, it was necessary to appreciate Africa's location as part of a larger whole – the modern world-system – whose structures and tendencies had been operating for half a millennium.

Beyond his direct experience as an Africanist, there were three intellectual traditions which contributed to Wallerstein's creation of world-systems analysis. First, his radical analysis owes much to Marxist and especially neo-Marxist ideas (see **MARXISM–LENINISM**; **NEO-MARXISM**). In a foundation paper, Wallerstein (1974b) explicitly locates his analysis within contemporary Marxist debates. Basically, he

allies himself with Marxists who maintain the world vision of their founder over the state-centric tendencies which have dominated orthodox Marxism. Later, writing in the 'spirit of Marx', Wallerstein emphasizes the concrete historical grounding of his work in contrast to the more abstract Marxisms which seem to have lost touch with contemporary social change; he calls his concept of capitalism 'historical capitalism' (Wallerstein, 1983). Second, world-systems analysis owes much to DEPENDENCY THEORY and its core-periphery analysis – especially the argument from ANDRE GUNDER FRANK (1967) that, while core countries might be developing, the periphery was experiencing the 'DEVELOPMENT OF UNDER-DEVELOPMENT'. Wallerstein took his basic spatial structure from this position and added a third category – SEMI-PERIPHERY – as a location between core and periphery. The development of this concept added a crucial dynamic zone to the original bipolar structure of dependency, providing world-systems analysis with one of its distinctive characteristics. Third, Wallerstein accreted crucial elements of the French *Annales* School of history to his thinking, especially the work of FERNAND BRAUDEL (1980). Two major features of Braudel's writings have been particularly influential: (1) Braudel's identification of three levels of human activity (an everyday material world at the bottom; a middle world of commerce; and, at the top, where he locates capitalism, high finance) and (2) Braudel's identification of different temporal perspectives in social analysis (the *moyenne durée* and *longue durée*, along with the traditional *courte durée* (eventism)). Wallerstein used Braudel to provide the temporal structures for his analysis. For *moyenne durée* purposes, Wallerstein was part of the general radical rediscovery of 'LONG CYCLES' as KONDRATIEFF WAVES in the 1970s, but in addition he identified longer cycles relating to the rise and fall of hegemonic states (the United Provinces, Britain and the United States).

Political differences over the 1968 student turmoils had led Wallerstein to reconsider his future at Columbia and, after his year at

Stanford, he did not return to his *alma mater* but moved on to McGill University in Montreal. He was a professor of sociology at McGill from 1971 to 1976, when he took up the position of Director of the Fernand Braudel Center for the Study of Economies, Historical Systems and Civilizations at Binghamton University. He stayed at Binghamton from that time, although latterly he held this position jointly with an appointment at the Maison des Sciences de L'Homme in Paris. Once established at the Fernand Braudel Center, Wallerstein set up a new journal (*Review*) that has operated as a sort of house magazine for the debates surrounding world-systems analysis. With the journal, numerous research working groups, conference sponsorships, a continual stream of international visiting scholars and the close support of Terence Hopkins and Giovanni Arrighi, the Center has carried world-systems analysis forward under Wallerstein's leadership to the present day.

Over the last two decades, Wallerstein's publications can be divided into three broad categories: (1) the continuation of the historical project started by *The Modern World-System* in 1974, (2) political essays, some on contemporary issues, all of which provide a longer than usual timeframe, and (3) methodological interventions in which he has promoted his transdisciplinary vision of the historical social sciences. It is in the nature of Wallerstein's work that these categories are integrated: for example, his interpretation of the French Revolution is relevant to all three concerns, so that my separation of them in the discussion below is for pedagogic reasons only.

Wallerstein has promised between four and six volumes describing the historical trajectory of the modern world-system. Since the first volume, two more have been published taking the story to the 1840s (Wallerstein, 1980; 1989). We can glean the outline of his treatment of the last century and a half from the organization of the published volumes and his more recent historical essays and projects. The two key organizing principles are clearly HEGEMONY (core-making) and incorporation (periphery-

making). In the former case, the focus is on British leadership in the nineteenth century and US leadership in the twentieth century, treated in a manner that transcends political and economic prowess to create the very mentalities of their respective ages. The demise of British hegemony is marked by the so-called 'age of imperialism' – the last great incorporation into the modern world-system of other historical systems that had been destroyed, the study of which will, in large measure, bring Wallerstein back to his original African interests. With the modern world-system effectively global by the beginning of the twentieth century, much of the US hegemonic cycle has been marked in the periphery and semi-periphery by attempts to loosen the incorporation or even to delink (see *DELINKING*). The middle-term failure of such attempts is a critical part of the story of the periphery up to the present, resulting in the contemporary consolidation of the global scope of the modern world-system (Hopkins *et al.*, 1996).

Wallerstein's work is inherently political and he does not recognize the possibility of social-science writing not being political. Nevertheless, we can select from his oeuvre essays which are overtly concerned with formal political matters. In turn, these can be divided into two types of writing: that concerned primarily with concepts for political analysis and that which attempts to inform contemporary politics. In the former case, Wallerstein (1984) offers an approach focusing on four prime institutions: states, classes, 'peoples' and households, with the latter acting as the 'atoms' of the system through which individuals attain membership of the other three. Each institution is implicated in the making and unmaking of each other, through what Wallerstein calls the 'institutional vortex' of the system. At the same time, Wallerstein identifies anti-systemic movements that operate to intervene in the vortex to change the system. While successful at one level, 'state-capture', they have been notably unsuccessful in their longer term aims. Wallerstein has also produced books with

Arrighi, Frank and Samir Amin (Amin *et al.*, 1982), which interpret contemporary changes in the capitalist world-economy of the 1980s, providing a strong sense of critical transformation. In his essays, contemporary politics has been interpreted largely in terms of the potential break-up of the political structures put in place by US hegemony – what Wallerstein terms 'post-America' (Wallerstein, 1991a; see also *HEGEMONY*, US).

Methodological questions are a central concern for Wallerstein (Taylor, 1989). Since nearly all accessible data and most analyses on social change use states as their prime units, it follows that much of Wallerstein's work is about recasting conventional history and social-science scholarship. There is an essential need, according to Wallerstein (1991b), to 'unthink social science'. By this, he means that the categories and concepts defined by social science's founding fathers about a century or more ago are showing their age. Instead of yet more adaptation to current realities, the time has come to start afresh – not least in bringing history back to the centre-stage from which it was dismissed through the creation of social science. Wallerstein calls this the 'crisis of the sciences', whose prime symptom is the current porosity of disciplinary boundaries. In the social sciences, this is reflected in more and more research which transcends the main disciplinary categories. In the Report of the Gulbenkian Commission into the Restructuring of the Social Sciences (Wallerstein *et al.*, 1996), practical measures are suggested to overcome disciplinary ghettos. Broader still, Wallerstein is interested in the breakdown of boundaries between the social and natural sciences, and between social science and the humanities. In the latter case, the rise of theory in the critical cultural turn of the humanities has led to one set of new intellectual continuities, while there is potential for another set of continuities with the discovery of dynamic, complex systems in the natural sciences: in short a new natural history, comparable to historical systems. Wallerstein sees getting the

methodology right as the crucial contribution scientists and scholars can make at this time.

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PETER J. TAYLOR

war

'War' is usually defined as being the armed struggle between two or more actors for reasons that are most often political: for example, the acquisition of territory. The concept of war is, however, a complex one due to the nature of different forms of armed struggle (guerrilla wars, civil wars, total wars and so on) and also as a result of the legal complexity that surrounds the subject, including the nature of international law (see LAW, INTERNATIONAL).

In theory, the rules of international law regulate the conduct of armed conflict between nations. First enunciated by HUGO GROTIUS in the seventeenth century, the international laws of war were developed in order to minimize destruction, outlaw the cruel treatment of non-combatants and prisoners of war, and establish conditions for peaceful negotiation. However, although agreements as to the laws of war have generally eased conditions for the sick and wounded, they have often failed to come to grips with the issue of weaponry. As a result, the complexity of modern warfare today poses difficult questions for theorists of international law, as well as for international relations analysts in general.

This is no less the case in the field of international political economy (IPE), where the relationship between economics and politics is particularly crucial in examining the nature and impact of war. In this regard, there are a number of issues that are of particular relevance. One of these is the question of the military strategy that a nation is able to undertake. Wartime priorities, even the actual choice of war as a policy, often largely reflect the constraints of an economy's capacity. Indeed, the idea that wealth even indirectly fostered war was popular until the nineteenth

century. From that time, a different link between economic conditions and war was favoured: economic necessity, as opposed to abundance, was seen as the new catalyst of war. In such theories, it was assumed that inadequate finance did not usually deter nations from initiating a war. Rather, nations were willing to launch an attack even if their financial situation was unstable or the level of national economic distress was high. The available evidence, however, suggested otherwise. The prevailing view, then, is that adequate finance, or access to it, is a prerequisite for war.

For example, as a nation begins to make itself ready for war, leaders will normally assess their potential opponents, including their economic capabilities, and then choose the most appropriate strategy based on such assessments. Indeed, every nation does, at some point, seem to stress financial factors in their choice of policy. For example, during World War I and World War II, the United Kingdom could very much be said to be a 'war economy', with the government controlling a larger portion of the national product than it would during peacetime. Indeed, under such circumstances, the state often secures the legal authority required in order to direct production, distribution and exchange. Its ability to do so effectively, however, often develops only gradually, as war immediately increases the consumption of foods, fibres, other raw materials and metals, diverting resources from manufacturing and agriculture and thus creating a general state of material shortages. Moreover, economic decisions must also be made with regard to a variety of issues. These include decisions regarding the choice between warships and aircraft, between numbers and quality, undertaking a regular war or an insurgency, firepower and mobility and also the choice between having a paid army or instead using voluntary forces or conscription to build a fighting force.

One interesting issue here that directly relates economics to war is the question of the use of mercenaries. 'Mercenarism' refers to the practice whereby professional soldiers rent out their labour and skills to a foreign power

for fees higher and above those of native counterparts. This can involve carrying out acts that regular armies would not be called on to perform, either because they are morally repugnant or because they violate the aforementioned international rules of war. The European colonial powers used mercenary forces in an effort to maintain control over their expanding empires. Since the late eighteenth century, mercenaries have largely been used in conflicts in Africa, although this is now changing somewhat given the end of the COLD WAR and the higher levels of instability in Eastern Europe. In particular, mercenary activity in the post-Cold War world has evolved in terms of its organizational structure, its connections to business and its clients, and also in the manner of remuneration. Unlike earlier mercenaries, the post-Cold War mercenary takes part in a highly diverse range of activities involving a variety of customers. These include sovereign governments, international agencies, foreign embassies and corporations. Moreover, modern mercenaries are rewarded in ways other than cash. One of the most common of these is trade deals, whereby security services and executive protection are offered in exchange for long-term diamond or oil concessions. In many cases, it seems that such methods of payment are preferred to the more traditional cash deals because of the strategic stranglehold that it allows the mercenary outfit to maintain with regard to the client state.

One area that is of particular importance in any IPE perspective on war is that of INTERNATIONAL TRADE, which assumes a peculiar quality during wartime. Transactions become one-sided and unequal, and commodities trade for political assets and capital transfers. For example, during both World War I and World War II, the United Kingdom ran up very large deficits overseas, as well as liquidating many of its overseas investments, in order to support its wartime allies. This policy later resulted in the need for massive injections of aid from the United States in the form of the MARSHALL PLAN.

Furthermore, in the contemporary highly globalized international system, the relationship

between international trade and conflict has taken on an even greater significance. A major part of any such discussion is to consider how trade and politics interact. Analysts have discovered, however, that not only is it difficult to incorporate the complex issue of war into a suitable economic framework, but also (even if this could be done) the consistency of any data-set used to analyse such interactions is debatable. Nevertheless, a majority of analysts agree that trade between two countries can result in mutual economic benefits and hence peace. International trade is viewed as enhancing cooperation and thus deterring conflict. This is particularly the case between two states that trade a lot. In this case, any threat to that trade in the form of war will have a much greater impact on both countries' economic positions. Thus, the more that international trade takes place between states, the greater the incentive not to obstruct that trade by going to war. For example, analysts have discovered that during the 1930s, the levels of international trade declined dramatically, possibly leading to some of the decline in international cooperation that preceded World War II.

In addition to the decisions regarding military strategy that result from a nation's economic position, and the relationship between war and international trade, one area of significant interest is the economic implications for a country of going to war. For economists, war (at least at a scale comparable to the two world wars) represents a profound waste of valuable human and material resources and economists are particularly concerned with the resource implications of war.

In terms of resource costs, there are a number of areas from which losses are generated. The first, and perhaps most obvious, is the direct and indirect human casualties that result from war. The loss of life during wartime is obviously not just confined to those that are directly involved in war, but also affects civilians who may be caught in the crossfire, deliberately killed in cold blood or who are victims of landmines and air crashes. Moreover, deaths caused by the conditions that often result from war (such as poor sanitation and

malnutrition) are far higher than even the combined military and civilian figures of direct war casualties.

Second, there are costs that arise from the long-term impact of war. These include the problem of forced relocation, where (for example) agricultural workers are driven into urban areas where it is more difficult for them to use their skills or children are driven away from their education. Such disruption can lead to a long-term skill gap, which has a knock-on effect on a state's ability to undertake a long-term programme of economic growth and recovery. This is further compounded by the loss or damage to physical capital and infrastructure that often arise in part as the direct result of war and in part as a result of disrupted or neglected maintenance work. This, in turn, has an effect on production levels and may result in the destruction of the economically productive sectors in an economy. Major disruption, for example, may be caused to water transport and irrigation, railways, bridges and roads, and to hotels and tourism. Also, there are other long-term costs that arise from such factors as the psychological effects of war – such as the devastation of the social fabric of a culture – that can result in long-running social conflict and the eventual continuation of war; the impact on health services – including the disruption of immunization and preventive medicine programmes; the extensive and long-lasting environmental damage that war generates, and the need to cover veteran's expenses and pay the interest on any war debt incurred. Moreover, in a significant number of countries, conflict has been conducted including the widespread use of anti-personnel mines that render former agricultural areas unusable and continue to inflict casualties on civilians for decades after the war is over.

Given the large costs associated with war, states have to consider the policies through which such costs can be financed. From a domestic perspective, the two major ways are either to increase government revenue or to divert it from some other use. In terms of increased government revenue, governments could choose to finance a war by increasing

taxation, borrowing from the public (for example, through the sale of government BONDS) or by printing banknotes (SEIGNIORAGE) – although this can lead to excessively high levels of INFLATION. Moreover, such solutions to wartime finance presume the presence of a developed enough economic system to undertake such revenue increase. In terms of diverted revenue, such policies include the diversion of government expenditures towards the war effort or the payment of armed forces in kind.

From the perspective of foreign sources, a state could again attempt to increase its revenue in order to cover wartime costs, though this time by undertaking such policies as attempting to increase exports, or by receiving foreign aid from friendly governments or by borrowing from foreign commercial banks. On the other hand, a state could attempt to decrease expenditure by, for example, reducing the amount of non-military imports coming into a country. Such policies, however, do have long-term implications of the kind examined earlier.

Finally, each of the major theoretical perspectives on IPE have particular views with regard to the nature of war in the international system. First, and perhaps most obviously, the mercantilist approach argues that a state will play an active role in regulating economic activity in order to accumulate wealth and power as a means of enhancing its independence and, ultimately, its national security. Hence mercantilist policies were designed as ways in which to provide economic and military security for a state, with the state attempting to accumulate as much wealth as it could relative to other states. Having a strong economy meant that there would be money to pay for the accoutrements of war – to buy weapons, to provide reserves for shipbuilding, to feed soldiers and even to buy the services of mercenaries.

As a theory of state interaction, MERCANTILISM emerged in Europe between the sixteenth and eighteenth centuries, as a consequence of the increasing power of European NATION-STATES and the success of their overseas expansion. This was the period of ‘classical

IMPERIALISM’ when war, conquest and colonial development were frequent occurrences and mercantilism had a significant impact in the development of European empires as sources of precious metals, labour and raw materials. Moreover, its rise paralleled the coming to prominence of Britain as a global power and, indeed, it is the commercial influence that Britain had during this time that informed the development of mercantilist thought. Britain had emerged as a formidable land-power during the Wars of Louis XI. This rise to pre-eminence was aided by a number of factors, including Britain’s then superior technological knowledge and its extensive naval power. Indeed, the Royal Navy at that time both protected British trade and projected the country’s power wherever in the world it appeared necessary to do so. This can be seen in the Navigation Act of 1651, which was designed with the explicit purpose of protecting British shipping from foreign competition. Lucrative economic enterprises at that time depended ultimately on force for their success; this was an age of sea power and, in the struggle for power and prestige, the role of national navies was decisive.

Underpinning mercantilist thought was the idea that wealth could be transformed into naval power, which would protect trade, which in turn would provide more wealth, which would then go on to strengthen the nation’s naval power, and so on. This echoes the ideas of Francis Bacon (1561–1626), an early architect of Britain’s developing balance-of-power policy. For Bacon, wealth and military capabilities were mutually reinforcing dimensions of national power.

Thus the importance of international commerce in generating wealth made naval forces as important as military forces in providing national security. Legitimate grounds for war resulted from disputes over territory, populations and religion, and from questions of market share and commercial privilege. The historical result of mercantilism was to concentrate physical wealth in a few European nation-states and to create a network of global

economic interdependence whose vestiges remain today.

By the eighteenth century, mercantilists began to see that industrialization could provide the financial and technological means with which to mobilize a state's military strength, including a state's desire to have the maximum amount of self-reliance in military capability. To not have this was to leave a state vulnerable to the vagaries of war. Moreover, for the militarily successful combatant, war was profitable because, as a result of territorial expansion, it was not only able to secure new markets and resources, but it could also contribute to both a country's level of industrialization and its production potential. Nevertheless, industrialization – although it provided states with the means to accumulate more power – encouraged the creation of fresh social groups and forces. In particular, it stimulated the growth of an entrepreneurial class who viewed trade as a means to personal wealth rather than as a means, ultimately, to ensuring state security. Under such circumstances, war was an irrational and destructive force that lay largely outside the realms of a political economy that was established on the basis of rational behaviour.

There is still a large body of thought that maintains that it is national security concerns rather than economic concerns that drive the behaviour of states. This was particularly the case in the years following World War II, when nations defined their national security interests not only in terms of military security, but in terms of economic security too. The so-called 'neo-mercantilist' policies (see NEO-MERCANTILISM) that states followed at this time were often indirect, taking the form of EXPORT PROMOTION and protectionism as a means to achieving greater economic security within the post-war international economic order. This was the time of the Cold War, when both the United States and the Soviet Union used economic statecraft as a way of ensuring collaboration from third-party countries.

In contrast to mercantilism, with its strong role for the state, the roots of LIBERALISM lie in the notion that governments can often be too

intrusive in a state's economic activity: this informs too the liberal conception of war. Nineteenth-century liberals, for example, argue that war is 'the natural state of men ignorant of the laws of political economy'. In other words, if FREE TRADE is encouraged, the likelihood of political conflict and war diminishes. Because war undermines productive capacity and saps national wealth and power, peace is logically in the interests of every state. Nineteenth-century liberals considered war to be a ruinous enterprise for all participants, due to its direct losses (such as the destruction of capital and the reduction of international trade) as well as to its opportunity costs (such as its effects on civil production). They also objected to armed peace because armaments, with their consequences for increased taxation and ever-growing public debt, would also harm national WELFARE. In liberal opinion, peace should therefore be secured not by the armaments of militarism but by free trade. Free trade increases national wealth and international communication, thus leading to the peaceful cooperation of nations within the framework of enlightened patriotism. Such notions find favour too in the economic pacifism that was so prevalent before 1914. Its principal arguments aimed at the potential costs of war and the actual costs of armaments being too high for military options to be a rational means for pursuing national interests. Even if militarily victorious, a state cannot increase its wealth by the acquisition of new territories or by weakening the enemy's commerce and industry, because the newly gained subjects are still competing with the victor and can now take advantage of a beneficial trading relationship. Moreover, any destruction of the opponent's property decreases the value of the conquered territory and eliminates an important customer of the victor. The loser can even gain some advantage from having to pay reparations: massive inflows of money to the winning country's economy increase its price level and lead to improved export chances for the vanquished.

In addition, for economic pacifists, war would also lead to a loosening of the monetary

discipline of governments and parliaments and a total breakdown of international finance and investment. This confronts even the winner with the danger of bankruptcy. Finally, the economic net outcome of war has to be negative for all sides, because of the fact that modern military technology leads to mass slaughter of the armies. While war is thus always bad for business, the same is true for armaments – even if they are purely defensive. On one hand, the arms build-up results in an immense increase in public debt and consequently in higher taxes and interest rates, crowding out civil investment and preventing expenditure for social purposes. On the other hand, massive investment in naval power does not pay, because military means cannot help to promote trade and commerce in the world market. Thus, if a country's economic wealth is not only independent of an increase in its military capacity, but even hampered by it, the logical consequence must be the historical necessity of disarmament and the end of war as a political and economic instrument. Although the ideas of economic pacifism are extreme, they do fall in with liberal notions that it is economic stability that brings peace and prosperity, rather than the build-up of arms. Such ideas can be seen in more recent times, with the creation of the liberal post-war trading structure. Policy-makers very much felt that the GREAT DEPRESSION of the inter-war years was an example of serious flaws in the market that had contributed to the outbreak of World War II. A more liberal post-war trading structure might prevent such events from happening again.

Finally, the structuralist perspective (see STRUCTURALISM) views all political phenomena, including war, as a projection of underlying economic forces. From this perspective, there are two competing views on the nature of war. One view, for example, holds that war and armaments are a material and moral evil resulting from the rotten capitalist economic and social order based on private property and the class structure. While profitable for the ruling classes, the negative total balance of war and its preparation is paid for by the poor mass of the people. Securing a lasting peace therefore needs a change of the social and economic

basis of the existing political system. Socialist communities, created by elimination of private property, competition, exploitation of the workers and corruption, will form a global federation that will be able to overcome all causes of war and, finally, the idea of war itself.

On the other hand, some structuralists argue that war, as well as other forms of aggression, stem from frustration and deprivation. Studies show, however, that the poorest countries cannot afford to make war. Thus, as nations develop, they are better able to afford the weapons of war. The problem with this perspective is that while many government officials, especially in LESS-DEVELOPED COUNTRIES (LDCs), continue to employ the structuralist critique to explain the origin of many of their national security problems, the approach itself offers little in the way of concrete strategies that the state might employ to solve those problems. Short of revolution or a complete reordering of the distribution of wealth and power in the international political economy, state leaders must also balance a variety of national security concerns with their economic capacity to solve these problems.

See also:

globalization; industrial revolution; Marxism-Leninism; realism; sanctions. economic

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ALISON M.S. WATSON

war cycles

The concept of 'cycles' in world politics rests on the argument that aspects of human activity, at least occasionally, may be cyclical in character. Some concept of cyclicity is widely employed by analysts of world politics and INTERNATIONAL POLITICAL ECONOMY (IPE), although many scholars believe cyclicity in both areas is impossible. What is meant by 'cyclicity' differs greatly between analysts, from the possibility of sporadic repetition to deterministic loops of behaviour. Some scholars envisage processes of change (for example, state-collapse) being repeated, others claim that specific events recur.

Economics often provides a basis for theories of cyclical behaviour in world politics, although not all analysts of world politics employ economic factors as a basis for political cycles. War is also often seen as occurring in cycles, so that some scholars claim that 'war cycles' are a predictable aspect of INTERNATIONAL RELATIONS (IR).

War cycles are patterns of warfare that are said to be repeated over long time-spans, so that regular intervals separate phases of violence. The best-known work on war cycles has been that by Modelski (1987a), but other scholars have also made notable contributions to this debate.

Modelski argues that a series of stages can be identified in world political history, each asso-

ciated with a leading sector actor or 'hegemon'. These stages are punctuated by major wars, in which the victor recasts the international system according to their own principles and in their own favour. Eventually, the costs of retaining pre-eminence will overcome the hegemon, so that the pattern will be cyclically repeated. In Modelski's view, this repetition has occurred in a regular fashion over the last 400 years, with similar intervals between major wars. Modelski has recently combined this cyclical view of war with a co-evolutionary approach to world politics, linking political, economic and military activity (Modelski and Thompson, 1996). In Modelski's view 'LONG CYCLES' characterize international relations.

Organski adopts a different approach (Organski and Kugler, 1980), based on 'power transitions'. He suggests that when a 'great power' declines to be replaced by a successor 'great power', war tends to occur in the transition phase. This must be differentiated from 'power-cycle theory' proposed by Doran. Doran (1991) argues that economic factors cause states to rise and decline, so causing changes in capabilities. This argument is similar to that used by GILPIN (1981) who proposed that, over 2,400 years, states have grown and declined for economic reasons, and that this too has a cyclical character. Because these patterns can cause wars, a cycle of war can exist according to these perspectives too.

The work of all these scholars can be characterized as STRUCTURAL REALISM, in that it is state-centric but concentrates on the way in which non-state factors affect states. Approaches stressing cyclicity are also widely used in STRUCTURALISM in IR, especially in WORLD-SYSTEMS THEORY, but these do not generally involve 'war cycles' of this sort. However, not all structural realists agree that war cycles exist and such cycles remain a controversial aspect of debates within the academic study of IR in general.

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KEN DARK

warfare state

The concept of the 'warfare state' is often used as a convenient shorthand to denote that part of the institutional architecture of the STATE that is devoted to the management of the armed forces, military strategy and procurement, and defence industrial policy. The warfare state has been most frequently deployed in the analysis of the historiography of the United States and the United Kingdom, because it is in these societies that the relationship between politicians, the military and big business has been most frequently identified as one of the keys to understanding the developmental role played by the state during the respective eras of first British and then American HEGEMONY over the management of the international economy.

In the United States in particular, it has been customary for the activities of the warfare state to be discussed in terms of the notion of the 'MILITARY-INDUSTRIAL COMPLEX (MIC)' – at least since the publication of C. Wright Mills' *The Power Elite* (1956), in which Mills warned of the capacity of a 'power elite' composed of political, corporate and military interests to constrain the political choices made by US society, and President Dwight Eisenhower's January 1961 farewell address, in which he warned of the threat posed to the democratic

process by 'the acquisition of unwarranted influence, whether sought or unsought, by the military-industrial complex' (Eisenhower, 1961: 206).

As Keith Nelson has noted, the distrust of the politician, soldier and bureaucrat as they relate to war is hardly a novel phenomenon, since the lineage of the warfare state may be traced back at least as far as the writings of Aristotle (Nelson, 1972: 17). However, Paul Koistinen has asserted that the economic mobilization of the modern warfare state in the United States may be understood in terms of three distinct stages. First, the pre-industrial stage, best characterized by the American War of Independence, when the institutions of the warfare state were in an embryonic stage and not clearly distinguishable from one other. Second, the transitional stage, best characterized by the American Civil War, by which juncture the Union's economy was quite industrialized and the military partly professionalized, but military technology relatively underdeveloped, which necessitated the diversion of civilian industries into military production. Third, the industrial stage, characterized by twentieth-century warfare, which has witnessed an increasing level of integration and complex relations between the institutions of the warfare state, the armed services and the business community (Koistinen, 1980: 6–9).

This increasing integration of politicians, military and industry was reflected during World War I by the creation in the United States of the War Industries Board, which gave the warfare state the capacity to control and mobilize the wartime economy in a coordinated manner that had not been possible during the Civil War. However, because of numerous examples of profiteering (rather than the sacrifice and patriotism that had been expected) during World War I, those responsible for planning mobilization for World War II ensured that the warfare state equipped itself with the power not only to tax all sources of wartime income and thereby finance the war without the recourse to excessive national debt, but also to draft into federal service any recalcitrant business or industrialist (*ibid.*: 12).

The warfare state enjoyed particular salience during the era of the COLD WAR, when global military spending, in constant terms, more than doubled from around US\$100 billion in 1951 (at 1970 prices) to more than US\$200 billion in 1970. There was a further acceleration in global military spending during the 1980s, reaching a peak of US\$1000 billion in 1987, as a consequence of the Reagan administration's attempts to outspend and bankrupt the Soviet Union's warfare state (Kaldor, Albrecht and Schmeder, 1998: 1). With the collapse of COMMUNISM, the resources consumed by the warfare state have progressively declined from an average among NORTH ATLANTIC TREATY ORGANIZATION (NATO) member-countries of 4.8 per cent of GROSS DOMESTIC PRODUCT (GDP) in 1985 to 2.6 per cent in 1999.

One of the central debates in the political economy of the warfare state has concerned the relationship between military spending and economic performance. For example, Paul Kennedy has identified the danger that if too large a share of national resources is devoted to the warfare state in order to provide the military power required to acquire and protect national wealth, and too little a share devoted to wealth creation itself, national power is likely to be weakened over the longer term. Indeed, the history of successive empires, including the British Empire (see EMPIRE, BRITISH), demonstrates that the financial and strategic costs of 'imperial overstretch' (see OVERSTRETCH THEORY) may ultimately usher in a period of prolonged relative economic decline (Kennedy, 1998: xvi, 515).

Mary Kaldor has asserted that '[m]odern military technology is not advanced; it is decadent' because its ever increasing complexity and cost has served only to undermine military effectiveness (Kaldor, 1982: 3). Indeed, studies of the defence industries in Western industrialized nations (for example, DeGrasse, 1983) have suggested that not only is there 'a striking inverse association between the share of GDP devoted to military research and development and international competitiveness in manufactures', but also competitiveness seems to have a

stronger negative association with military RESEARCH AND DEVELOPMENT (R&D) than it has a positive association with civil R&D (Kaldor, Sharp and Walker, 1986: 31).

The military historian Correlli Barnett has audited the performance of the British warfare state during World War II as a means of identifying the root causes of the post-war relative economic decline in the United Kingdom. Barnett's thesis is that national industrial strength is the essential basis of both national power and material prosperity, and that 'total war submits nations to a ruthless audit of resources, talents and failings: human, social, cultural, political and technological no less than military' (Barnett, 1986: xi). Therefore, by analysing the performance of the warfare state when confronted with the ultimate challenge of total warfare, Barnett has sought to demonstrate that neither the British state nor manufacturing industry would have been able to survive the Nazi onslaught without the crucial intervention of LEND-LEASE munitions, machine tools and related supplies from the United States.

For Barnett, the lesson of the failure of the British warfare state during World War II is that post-war governments should have accorded primacy in their reconstruction agendas to state-led industrial modernization. However, Barnett has asserted that this modernization was subordinated both to the 'the Dream of New Jerusalem' – that is, the creation of a WELFARE STATE based on 'an open-ended social security scheme and free national health service, full employment, and a colossal house-building programme' (ibid.: 15) – and to the illusion that the United Kingdom would remain 'the third world power' (after the United States and the Soviet Union), which resulted in the maintenance of a bloated warfare state that delivered only financial, political and strategic overstretch on a global scale (Barnett, 1995: xiii).

Barnett's thesis that the warfare and welfare states in the United Kingdom have both undermined the state's commitment to industrial, scientific and technological modernization has been subjected to a withering critique

from David Edgerton who has identified a very different historiography of the warfare state in England (Edgerton, 1991a). Edgerton has shown how the warfare state has been central to Britain's grand strategy as an economic, industrial and commercial power from the early nineteenth century through to the present day. His thesis is that, by pursuing an ideology of 'liberal militarism' which exploited England's 'relative strengths, most notably in science and technology and specific classes of industrial expertise', the warfare state has been able to overcome the absence both of a large population and mass conscript armed forces to maintain British global interests on the basis of the superiority of its military technology (Edgerton, 1991b: 149).

In its infancy, from the Battle of Waterloo (1815) to the outbreak of World War I (1914), the power of the British warfare state was expressed in 'navalism': the projection and protection of economic interests through unrivalled naval power. From 1914 to 1945, the warfare state was sustained by 'airforce-ism' – that is, the deployment of a large strategic bomber force that threatened destruction not only of enemies' armies, but also their cities and civil industrial power. During the Cold War era, the warfare state relied on 'nuclearism' – the deployment of nuclear power – because it was regarded as being cheaper and more militarily effective than the maintenance of conventional armed forces. Since the collapse of COMMUNISM, and with the onset of the GULF WAR and peace-enforcement duties in Central Europe and the Middle East, the British and American warfare states have united in a new '*Pax Technologica*', under which their respective nuclear weapons have been supplemented with high-technology 'smart' weapons (such as Tomahawk cruise missiles) that only a few nations possess the scientific and industrial capacity to produce (ibid.: 141–8).

The failure of the *Pax Technologica* to dislodge Saddam Hussein from Iraq or to deliver a decisive 'surgical' military strike in either Bosnia or Serbia has demonstrated the limitations of even the most powerful of

contemporary warfare states. Furthermore, the Iran–Contra hearings in the United States and the more recent Scott inquiry into the 'Arms to Iraq' scandal in the United Kingdom have served as timely reminders of Eisenhower's warning of the dangers to liberal democracies of the insufficiently constrained powers of the warfare state.

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SIMON LEE

Warren, Bill (1941–78)

The impact of Bill Warren's work on Marxist DEVELOPMENT theory is enormous. Born in Glasgow, Warren had a tragically short aca-

demic career, mainly at the School of Oriental and African Studies (University of London), dying at the age of thirty-seven.

Although his early work included an important contribution to debates around the relationship between international CAPITALISM and the NATION-STATE, his most important work focused on the relationship between capitalism and development in the so-called 'THIRD WORLD'. In 1973, he published an article in the *New Left Review* challenging prevailing left orthodoxy and arguing that capitalism was developing in the periphery (Warren, 1973). Indeed, he argued that conditions were particularly favourable for late developers, as they could (for example) attract foreign investment and import technology on favourable terms.

These arguments were developed further over the next few years and collected in a posthumous volume entitled *Imperialism: Pioneer of Capitalism* (1980). This work argued for a return to the original thesis of KARL MARX that IMPERIALISM was progressive because it developed capitalism in the colonies (and semi-colonies). Marx had seen this as a desirable outcome because capitalism developed the productive forces and, with them, the objective basis for the elimination of scarcity, and also because it created the subject that would overthrow alienated social relations – the proletariat. These arguments were in sharp contrast to those (since Lenin's day) of most of the revolutionary left, which had argued that imperialism hindered capitalism. For instance, in the 1960s, UNDERDEVELOPMENT theory mechanically argued that capitalism developed by literally underdeveloping the Third World.

Warren's work constitutes a sharp rebuttal to much of the crude anti-imperialism of contemporary Marxism. He rightly pointed to the undeniable fact of capitalist development in much of the periphery and showed that participation in the world system through trade and attracting foreign investment did not entail stagnation. He also argued that anti-Western political positions were not necessarily progressive and so did not deserve the blanket support

of Marxists – a position which seems even more relevant since Warren's death.

On the other hand, Warren at times is as guilty of over-generalization as the positions he criticizes. Indeed, in many respects his arguments are often a 'mirror image' of those he criticizes (Gulalp, 1986). Where underdevelopment theory saw inevitable stagnation, he saw inevitable development; where dependency theory saw the impossibility of national development, he saw its inevitability. Although he continually referred to UNEVEN DEVELOPMENT, there was little attempt to concretize this phenomenon. Warren paid little heed to the changing forms of CLASS STRUGGLE and CLASS FORMATION in the periphery, and therefore his analysis neglected the diversity of capitalist development in different parts of the world. Similarly, Warren paid insufficient attention to global unevenness, assuming that an increase in capital investment in the periphery was sufficient to reduce global disparities in the long term. This position in some respects replicated the errors of underdevelopment theory: while Warren saw foreign investment and trade between FIRST WORLD and Third World as inherently developmental, ANDRE GUNDER FRANK regarded them as inherently underdevelopmental. However, neither position accounted for the fact that trade and investment *within* the First World has been and continues to be far greater than trade and investment *between* First and Third World.

Despite these flaws, Warren's work remains an important corrective to the false certainties of a particular trend of radical development theory.

See also:

colonialism: core-periphery model

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RAY KIELY

Washington Agreement

The Washington Agreement was concluded by the United States in December 1945 and was then endorsed by the US Senate in July 1946. Under the terms of the agreement, \$25,000 million of LEND-LEASE aid granted to the Commonwealth was written off and the United Kingdom was given a long-term loan of \$3,750 million. Despite the fact that the sterling value of this agreement was £931 million in 1945, even three decades later – given the ensuing sterling devaluations and the advent of FLOATING EXCHANGE RATES – the amount outstanding had actually risen to £1,264 million.

See also:

Marshall Plan

ALISON M.S. WATSON

Washington consensus

The term 'Washington consensus' refers to the agreement of outlook among the multilateral agencies in Washington – the WORLD BANK and the INTERNATIONAL MONETARY FUND (IMF) – on a set of free-market policies that would form the basis for the conditions under which those agencies would lend to DEVELOPING COUNTRIES. The consensus developed in

the 1980s and was heavily influenced by the agencies' experiences in Latin America, where poor development performance was seen as the result of inefficient IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI), BALANCE OF PAYMENTS difficulties and high domestic INFLATION fuelled by large government budget deficits.

STABILIZATION POLICIES and STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) were the vehicles for imposing market-oriented conditions on borrowers. Typically countries would be asked to control inflation by restricting money-supply growth and reducing budget deficits. Large devaluations were frequently suggested and countries were encouraged to promote LIBERALIZATION by reducing barriers against imports with a view to eventually achieving FREE TRADE. PRIVATIZATION of state-owned enterprises and financial DEREGULATION were also key elements in Washington consensus policies. Governments were expected to withdraw from economic activity and intervene in the economy as little as possible. 'Getting the prices right' was seen as the most important factor in promoting successful development and free markets were expected to achieve this.

In the 1990s these policies have been questioned, not only by academic writers but also by the World Bank itself. The experience of the East Asian NEWLY INDUSTRIALIZING COUNTRIES (NICs) has suggested that the state can promote development by intervention in the economy. The double-digit annual GROSS DOMESTIC PRODUCT (GDP) growth in China since the start of its economic reform programme in 1978 has not been achieved by universal free markets, free trade or widespread privatizations; the ASIAN CRISIS was not the result of too much government intervention, but of a failure to regulate financial markets.

Increasingly, a 'post-Washington consensus' is emerging, which stresses that markets can fail – especially financial markets and markets for technology – and that governments should intervene to promote domestic competition, regulate financial transactions, promote educa-

tion and stimulate the inward transfer of technology.

See also:

conditionality; market failures

Further reading

Stiglitz, J. (1998) 'More instruments and broader goals: Moving towards a post-Washington consensus', WIDER annual lecture of United Nations University World Institute for Development Economics Research, Helsinki. Available at <http://www.wider.unu.edu/> (then use search for Stiglitz). Very clear and full statement both of the Washington consensus and its shortcomings. Also contains a substantial bibliography.

JOHN THOBURN

Weber, Max (1864–1920)

Weber's contribution to the social sciences was extensive, leaving a substantial legacy of concepts to a variety of disciplines. Few would doubt his place as a thinker of the first rank. His career spanned the period from the establishment of Bismarck's newly unified Germany to the collapse of that order at the end of World War I. During this time Weber held academic appointments in politics, economics and sociology, but was also unable to continue with his teaching because of breakdowns in his health. The range of his scholarly output was vast, extending from major studies of ancient civilizations through the philosophical and methodological foundations of the social sciences to discussions of the present state of, and future prospects for, modern Western CAPITALISM. From the point of view of POLITICAL ECONOMY, the main areas of interest are probably the methodology, the accounts of the rise and structure of capitalism, and the analysis of the interests of the NATION-STATE. Weber's methodology argues for an anti-empiricist stance in which knowledge is

conceptually formed. Modern Western capitalism was, for him, in many respects unique, arising as it did from a complex range of interlocking phenomena. In the overtly political realm Weber's overriding interest was in the exercise of **POWER** in its manifold forms.

Introduction

It would be difficult to overestimate the contribution of Weber to twentieth-century thought. While not as readily recognized as, say, Freud or **MARX**, Weber's contribution has been neither less important nor less profound. Many of the themes in his writings have found their way, often unacknowledged, into a range of longstanding and contemporary debates. The fate of work and the 'work ethic', 'bureaucracy', 'charisma', 'power' and 'domination', 'rationality' and 'rationalization' are themes that owe much to Weber and which have spread beyond the boundaries of academic work. Similarly, Weber's academic and political writings are themselves not bounded by any one academic discipline. The breadth of his scholarly interests was such that probably more harm than good would result from an attempt to locate them too precisely in this or that aspect of the social sciences and humanities. This is not to say that Weber's *opus* was sufficiently vague and diffuse to fit into almost any disciplinary framework. Quite the opposite seems to be the case on at least two counts. First, the contributions made by his work are of such wide-ranging interest and significance that they could not fail to address issues pertinent to a number of disciplines: law, politics, economics, history, philosophy and sociology come readily to mind. Second, the erosion of some disciplinary boundaries has helped foster an intellectual climate within which the breadth of Weber's work is more rather than less relevant to social science.

The social, political and intellectual background

The fact that Weber's life was bounded by the rise of Bismarckian Germany to unification as

a nation-state and the collapse of that order at the end of World War I, offers some indication of the themes that helped shape his life and work. The emergence of a self-confident sense of national identity, particularly among the upper middle classes to which Weber belonged and with whom he identified, coupled with an interest in expansionist policies which sought a more international role for Germany, influenced his approach to **NATIONALISM** and power politics. This confidence and expansionism contrasted with the doubts and anxieties, arising from the defeat of 1918, which also find a place in his writings. Neither the confidence nor the more pessimistic turn in both Weber and the wider context of German thought can be read as simple 'reflections' of the prevailing economic and political conditions as the cruder forms of Marxism (see **MARXISM–LENINISM**) might suggest. Both are closely connected to more diffuse but no less important trends in philosophical thought: on one hand, the influence of enlightenment optimism which Weber himself suggested to be irretrievably fading; on the other hand, a sense of a lack of fixed moral certainties in a world characterized by competing and irreconcilable perspectives such as we find in Nietzsche, in Ernst Troeltsch's perception of a crisis in **HISTORICISM**, in Georg Simmel's portrayal of the alienating and fragmentary nature of modernity, and in Weber's methodological and political essays.

Throughout Weber's work, political and economic issues were interwoven with those arising from the existence of a growing working-class movement, the rapid development of Germany as a capitalist economy, and debates on Marxism and matters of social policy. These issues of social policy raised in a direct way the problem of the relationship between practical matters and academic work – a problem that helped Weber to clarify his views on the foundations of social science. Alongside the more substantive works he engaged forcefully in the methodological disputes current at the time. The intensity of these arose, in part, from the political background but also from a longstanding sense of the distinctiveness of

the humanities. The belief that the growing power and prestige of natural science in the German university threatened this distinctiveness; the ambiguous place of the emerging social sciences; POSITIVISM and the confrontations between it, idealism and the German Historical School (see HISTORICAL SCHOOL, GERMAN), all encouraged protracted, convoluted and often still unresolved methodological controversies.

A sketch of Weber's life and work

Max Weber was born while his father was a magistrate in Erfurt, moved to Berlin in 1869 and spent his earliest years in a household well connected with the academic and political life of the time. His somewhat worldly father became a member of the Reichstag, while his mother was guided by a strong sense of religious duty not shared by her husband. Weber read law, economics, history and philosophy at the universities of Heidelberg, Göttingen and Berlin, also attending seminars at Strasbourg during his military service. He qualified as a junior barrister while working towards the first of his doctoral theses on the legal and economic history of medieval trading companies. This was awarded in 1889 and was followed two years later by his 'habilitation' thesis on the agrarian history of Rome. In 1893 he married Marianne Schnitger who wrote the definitive biography of her husband (published in 1926, but only available in an English translation since 1975). Weber was appointed to a professorship of economics at Freiburg in 1894 and in May 1895 delivered his more than blunt inaugural lecture on 'The nation-state and economic policy'. A chair in politics at Heidelberg (1896) marked a high point in his teaching career. July 1897 saw a quarrel with his father, primarily over the latter's treatment of Weber's mother. This conflict and the death of his father in the following month seem to have encouraged the psychological and physical breakdown which he documented in some considerable detail. Marianne destroyed this intimate account during World War II to prevent it falling into the hands of the National

Socialists. Weber did not return to teaching until late in his life, when he held professorships in Vienna and Munich. During these closing years Weber moved, to some degree, from the puritanical ethos of his mother's world towards an acquaintance with more bohemian culture, with thinkers who, although otherwise very disparate, were united in standing at a great distance from that Protestant rationalism and sense of duty which also formed part of Weber's character. These included those under the influence of Nietzsche and Tolstoy, those associated with the Stefan George circle, thinkers from the intellectual, cultural and sexual ferment of Munich's Schwabing and the antinomian exile communities that flourished in the luxuriant atmosphere of the Italian Lakes, particularly Ascona on the Swiss shore of Lake Maggiore. From these, from his massive studies of world religions and, finally, from his own private life, Weber became more aware of the tangled relationships between rationality, mysticism and eroticism.

Prior to the breakdown of his health, Weber had written on the stock exchange and 'traditionalism' among farmworkers, topics which gave some impetus to later research. He became involved in nationalist politics, joining the Pan-German Union, but withdrew on health grounds and because of disagreements over policy, particularly the question of the conflict of interests between agriculture and nationalism in the controversy surrounding the settlement of Polish farmworkers. A new phase of productivity began in 1902–4, when Weber accepted an honorary professorship at Heidelberg; he worked on methodological essays and a study of the formation of the modern world order, the first fruit of which was *The Protestant Ethic and the Spirit of Capitalism* (1930 [1904–5]). Thereafter, these interests were expanded into a comparative study of the 'economic ethics of world religions' which, together with the studies of Rome and the Middle Ages, provided an analysis of cultures on an unmatched scale. Even so, Weber would be the first to acknowledge their incompleteness. This he saw as both a practical matter and

an issue of epistemological principle, since all knowledge was necessarily partial. The last years of Weber's life were mainly devoted to drawing together these strands in *Economy and Society: An Outline of Interpretative Sociology* (1968 [1921–2]) and in *General Economic History* (1981 [1923]). Like Marx's *Capital*, Weber's *Economy and Society* is a vast, complex, but ultimately incomplete text.

During World War I, Weber worked on the organization of military hospitals. Thereafter, he attended the 1919 Versailles Conference, became a member of the German Democratic Party and, in that year, taught at the University of Munich. After a brief illness, Weber died of pneumonia on 14 June 1920.

The philosophical and methodological foundations

As is to be expected Weber's work rests on a range of philosophical, methodological and ethical views that set the tone for much else. Epistemologically the essential contrast (derived from Kant) is that between the infinite complexity of the potentially knowable and our finite capacity to know. In flat contradiction of empiricist attempts to capture reality as a set of incontestable facts, Weber argues for the necessarily limited and partial nature of knowledge, which is constituted through the interdependence of fact and theory.

This epistemological stance is developed in a range of essays on method which address both specific controversies and more general issues related to the nature of social science. Among these controversies was the famous quarrel over methods in economics that was already twenty years old by the time Weber entered the fray. His Kantianism provided a critique of both the empiricism of the historical school and the view of generalizations adopted by their marginalist opponents. Although Weber regarded himself as an offspring of the historical school, whose chief representative in the methodological dispute was Gustav Schmoller, he found their enthusiasm for the inductive gathering of 'facts' to be lacking in a sense of the conceptual element in the forma-

tion of knowledge. Here Weber takes up the Kantian rebuttal of empiricism, but does not include in this methodological stricture a rejection of the aims of the historical school, particularly the centrality of historical detail and historical explanation to accounts of social life. To this extent he retained the underlying assumption of historicism within his work. The degree to which Weber persisted with this view is a matter of some dispute in the literature. Some argue that he made a break with the more historical tradition in favour of a greater emphasis on a search for generalizations and that this break should be characterized as a move from history to sociology. An alternative interpretation suggests that, even if generalizations play an important part in his work, as they undoubtedly do, they serve as means to an end rather than ends in themselves. That is to say that the role of generalizations was to help draw out the characteristic uniqueness of social life.

Claiming a subordinate role for general theories does not in any way diminish the significance that they have for Weber or for social science. The point could hardly be otherwise, given the centrality of the conceptual and definitional in *Economy and Society*. His central claim, and here the issue was raised against the more analytic and deductive approach of marginalists such as Carl Menger, was that the epistemological status of concepts had been misconstrued. The conceptual framework of social science does not consist of a set of 'laws' after the fashion of the nomological propositions of natural science, nor do these concepts provide a closed system from which conclusions can be deduced. Given, for example, the premises in theories of price, rent or interest, the empirical outcome is in some sense 'determined'. This Weber regarded as a fantastic claim, since the only assumption upon which it could be sustained would be that the totality of all relevant conditions must be known in their entirety. Neither common-sense nor Weber's Kantianism will allow this possibility. In place of the nomological view of social-scientific generalizations, he proposes that we regard them as 'IDEAL TYPES'. This

claim has itself generated an enormous literature, which is by no means consistently favourable to Weber's position. The seemingly abstract detachment of these types from reality has proved to be a longstanding criticism.

Perhaps the major achievement here is that Weber turns academics back time and again, since the debates have proved to be recurring ones, to the need for a reflective self-awareness of the scope and nature of their disciplines: in short, back to the very idea of anything that might count as social science. It makes the greatest difference, to take a fundamental example, to accept or reject the claims that human action is caused and that we can only speak of cause when it is grounded in nomological propositions. Similarly, the very ideas of what are to count as politics, political economy, sociology, economics and psychology take radically differing shapes depending on the view taken on the debates to which Weber made so large a contribution.

His ideal types arise from an anti-empiricist stance that rejects the possibility of direct and unambiguously factual observation of social life. They are idealizations in a logical rather than a moral sense and provide abstract conceptual exaggerations of phenomena which, in their pure form, are not found in reality. Idealizations of this kind (for example, 'power', 'class', 'status', 'party', 'charisma' and so on) are not the main goal of analysis, but they are, in Weber's view, essential to the understanding of the complexities of the social. The very unreality of ideal types highlights the empirical details, contradictions and ambiguities of the subject matter. Even here something of the labyrinthine complexity of his thought is in evidence. Precisely because these types can be constructed from varying points of view, analysis knows no final resting point. It always remains open to being supplemented or surpassed by further research.

All such analyses are, Weber argues, related to the world of values. While it is perfectly true that he insisted on the separation of matters of fact from value judgements, Weber's position is often misunderstood. Positivism makes much of Hume's distinction between 'is' and 'ought'

as the basis of an empiricist and value-free social science – a view which seems rather unfair to Hume and, more generally, the Scottish enlightenment given the interest these writers displayed in the idea of a *moral science*. Weber would not doubt Hume's basic distinction, with reservations about the latter's empiricism, but the Humean dichotomy was not the direct source of his separation of facts and values. Here, as in much else, the inspiration is Kant and rests on his distinction between *The Critique of Pure Reason*, upon which the 'phenomenal' world of empirical knowledge is founded, and *The Critique of Practical Reason*, which concerns itself with the moral law. This distinction, which was a central element in Weber's inheritance from German idealism and from his upbringing in a Protestant sense of duty, provided him with an absolute repugnance for any confusion between scientific analysis and moral or political evaluation. This repugnance was based on the very high regard in which he held both science and morality. The premium that he placed on both these worlds suggests yet further complications. Despite his insistence on value freedom, Weber did not hold to the naive view that value premises could be expunged from the cultural and social sciences. Here there is a symmetry between the role of concepts and of values. In Weber's Kantian epistemology, the formless chaos of the potentially knowable is constituted as knowledge through the use of concepts to order and organize this endless flow of experience. Similarly, the process of selection from within this endless flow is, from the very outset, a matter of relevance to cultural values. Thus Weber is far from the view of the disinterested scientist detached from the world of values, while at the same time insisting on the duty to persistently and consistently draw attention to the need to struggle towards objectivity.

Often the aims of investigation included the desire to confront both analyst and audience with moral and political issues, as well as to continue in the pursuit of knowledge. Weber, however, found it untenable to claim that research could answer questions of ultimate

value. Science could not tell us how to live or what to do, since any attempt to do so removes from actors their obligations to choose between competing goals and their personal responsibility for such choices. Here the otherwise very disparate voices of Kant and Nietzsche come together in the insistence of the former on the morally autonomous agent who, at the same time, is called on by the latter to exercise that autonomy in a world in which it is at best difficult to appeal to any overarching set of values. A world, as Weber put it, of 'warring demons' or one, following Nietzsche, in which 'God is dead'. It would, however, be an inadequate interpretation of Weber, or of the influences on his work, to suggest a development from an ethic of duty and obligation towards some thoroughly nihilistic position. The essays on the 'vocation' or 'calling' of the scientist or politician more than confirm his passionate commitment to duty and responsibility in a calling, the more so in a world characterized by competing voices and irreconcilable values.

These philosophical underpinnings provided Weber's thought with an intensity that became almost totally obscured by the anodyne picture of him as the value-neutral social scientist. The intensity also arose from more political considerations. As early as his undergraduate years, Weber found the politicization of students – above all in Treitschke's lectures which extolled the virtues of Hohenzollern Germany – to be quite objectionable. Later, membership of the *Verein für Sozialpolitik* (Association for Social Policy) produced debates on the nature of BUREAUCRACY, matters of public policy, Marxism and capitalism, all of which heightened his sense of the problematic role of values in teaching and research. The limitations which he sought to impose were ideals that may not be realized in practice. Nevertheless, Weber thought that at the very least intellectual honesty requires that we try to achieve these ideals or, where we could not, to make as clear as possible the assumptions upon which analysis rests. These limitations did not include a self-denying ordinance of the kind that would exclude the taking of political or moral stands.

Weber, for example, was more than willing to embrace a vigorous advocacy of German national interests. He never fancied that these views should or could masquerade as science – the task of which was to provide clarity, analyse means and ends, and assess the possible consequences of action. He did, however, insist on the right and the duty to make moral and political choices.

Overall, these underlying assumptions place Weber within a broadly humanistic framework which has taken a variety of forms in subsequent thought. He sees the distinctive characteristics of an interpretative, hermeneutic and humanistic outlook as the understanding and explanation of action. This focus was (and is) often misinterpreted as a will to believe in our psychological capacity to rethink or relive an actor's thoughts – a form of empathy somewhat incongruously matched to a positivistic model of explanation. Neither point does justice to Weber's work. In the first place, the ability to understand rests not on psychological insights, although these may be relevant, but on historical scholarship, empirical research and ultimately the humanist assumption that actor's intentions are in principle accessible, however difficult and incomplete this access may prove to be in practice. Second, the model of explanation is rooted not in natural science but in German legal theory. Centring on questions of legal responsibility, this model of causality does not rest on nomological propositions. The focus is directed more towards often singular events which constitute an 'adequate cause' of the outcome under investigation: but for x then y would probably not have happened (at least not in that way); where it can be said that x was responsible, then it may be thought of as an 'adequate' as opposed to an 'accidental' cause of y .

Politics, power and domination

There is no doubt that the exercise of power in its manifold forms was a central concern throughout Weber's work. His later writings seek, as in the opening chapter of *Economy and Society*, to draw together a basic conceptual

framework for the discipline. Here he charts a path from a fundamental distinction between behaviour and action, through an analysis of the formation of social relationships by virtue of actors orientating their conduct to that of others, to distinction between these social relationships in terms of their degree of 'openness' or 'closure' to outsiders. Naturally, there is the greatest possible empirical variation in the workings of social inclusion and exclusion and Weber saw those relationships that tended to close or to limit membership as 'organizations'. Such closure is a major feature of social and political life, through which power is exercised.

'Power' is defined as any situation in which actors can achieve their ends despite the resistance of others. 'Domination' is more specific, referring to the exercise of power through a command enacted by an administrative staff and the probability that these commands will be obeyed. The most enduring forms of domination are those to which, on whatever basis, 'legitimacy' is ascribed by the participants. Thus Weber sought to develop ideal types of legitimate domination, through which historical and contemporary political arrangements could be analysed. These types are belief in legitimacy grounded in 'tradition' (an immemorial order), 'charisma' (the special qualities, often divinely ordained, of the leader) or 'legality' (the due process of law). The administrative apparatus through which these forms of domination are made effective admit of varying, and again ideal typical, possibilities. Charismatic domination is the least stable, tending in Weber's view towards schism or routinization. In so far as charismatic authority can be said to have an administrative structure, it would rest on 'disciples' or 'followers'. Traditionalism is primarily a matter of patriarchal, patrimonial or gerontocratic rule. Legal or rule-bound domination is, given the impersonality of the structure, carried by the ever growing world of the bureaucrat and the bureaucratic office. This concept had, for Weber, a far wider significance than its later adoption in the analysis of work and of organizations suggests. It occupies an impor-

tant place in his comparative and historical studies (of, for example, classical China), in his analysis of the rise and socioeconomic structure of capitalism, in his sociology of domination, and in his political essays.

There is a link between Weber's analysis of domination and his methodology. The idea of legitimacy rests on the actor's subjective belief (or lack of it) in the system – an orientation that blends with an interpretative methodology which focuses on the 'meaningful'. Weber does not, however, confuse these idealized forms with reality. A conceptual framework structured around beliefs in legitimacy does not require acceptance of the claim that, in every situation, such legitimation actually exists. Nothing could be further from his overall view of the inherently conflictual nature of the political order. These conflicts are largely between classes, status groups and parties, all of which are phenomena of the distribution of power. This analysis of power and domination is not a portrayal of specific political structures but is, rather, a range of concepts through which these structures can be analysed. Thus the existence of any specific form of domination, or of various combinations of these forms, is a contingent matter ruling out a deterministic progression from one type to another. Certainly legal and bureaucratic elements are very strongly present in Weber's view of the modern order, but there is no neat development from charisma to traditionalism to legality. Quite the contrary: Weber saw, even in the modern world, the possibility of charismatic leadership as a revolutionary force.

The more overtly political writings began to appear in the period after Weber completed his doctoral theses. The earliest of these writings focus on controversial questions of Germany's national identity, national interests and broader discussions of NATIONALISM. Initially these issues are addressed through the study of migrant (namely Polish) agricultural workers in Eastern Prussia, especially the tension that Weber saw between the economic interests of the Prussian aristocracy in cheap labour and the cultural and political interests of the German STATE. This tension provided the

starting point for his Freiburg inaugural lecture (1895) which placed economic policy in a subordinate position to politics, above all the political question of Germany's role as a great power.

In these discussions, which in later years extended beyond academic literature into newspaper articles, Weber frequently addressed the problem of a lack of a well-established liberal and parliamentary tradition in Germany. This deficiency arose from the authoritarian ethos promoted by Bismarck, the power of bureaucracy and the various interventions of the Kaiser in political life. This lack of a parliamentary tradition reappears in the discussion of the 1905 Russian Revolution. A subsequent essay on SOCIALISM left him unconvinced as to that road to a better future and equally unconvinced as to the scientific status of Marxism. This did not prevent him from seeing Marxism as massively influential and as a source of important and insightful ideal types. All in all, it cannot be said that Weber's political writings were inspired by any bland or indeed passionate optimism for the future. In part, this attitude was a function of the circumstances in which Germany was placed, but it also arose from the almost brutal realism of his views. Political economy does not, the 1895 lecture declares, hold out the hope of human happiness or peace. Similarly, Weber's 1919 speech on 'Politics as a vocation' invites German politicians to face a polar night of icy darkness and hardness in the post-war situation. The politician confronts this situation through an 'ethic of responsibility' in which the consequences of action are ever present. In contrast to this, Weber speaks of an 'ethic of conviction' rooted in absolute ideals that leave worldly considerations to one side. Although these two ethics are in genuine tension with each other, it is typical of the complexities of Weber's thought that those who would truly partake of the vocation of politics must be capable of embracing both. The brutal realism continues in his understanding of the state as an institution which claims the monopoly of the legitimate use of force in a given territory.

Similarly, violence is seen as the decisive means for politics.

Religion, capitalism and the economic ethics of the world religions

Summarizing Weber's views is probably nowhere more difficult than in this area, given the scale, complexity and scholarship of his contribution to the field. Moreover, these views have been debated endlessly and have been subject to the most varied and contradictory interpretations. Among these it would be quite safe to abandon any attempt to credit Weber with the opinion that Protestant Christianity was solely responsible for the rise of capitalism or even that ideas alone were the driving force in human history. These claims cannot be found in his work.

In general, Weber's outlook was one in which religious ideas, and those people who carried them into social practices, were of enormous significance for economic, social, political and cultural aspects of life. These ideas were always, and here Weber remains faithful to the philosophical and historical traditions of German thought, intertwined with so much else that he regarded as indispensable to the understanding and explanation of Western civilization and the distinctiveness of that civilization from those of the East. Thus the 'ideal' always existed in close relationship with 'material' interests, however varied that relationship might prove to be. Similarly, the religious roots of Western capitalism formed part of an account of a vast range of pertinent 'factors' (the term is inadequate, conveying as it does a sense of separable entities where Weber sought to emphasize their convoluted interdependence). These he reviews and summarizes in the closing section of his posthumously published *General Economic History*.

Here, as in *Economy and Society*, the question of the origins of modern capitalism is discussed in ways that make the claim that he thought of Calvinism as *the* cause of capitalism unrecognizable. First, he outlines those features that he regarded as the presuppositions for the existence of modern capitalism. He cites

rational capital accounting, freedom of the market, a rationalized technology, calculable law, formally free labour and, finally, the commercialization of economic life through the use of financial instruments such as shares. Beyond these, Weber argued for a very extensive and complex set of influences on the shape that capitalism took: commercial policy, speculative crises, the rise of wholesale trade separate from the retail markets, COLONIALISM, mining and industrial technologies, citizenship, the rise of the modern state with its formally rational legal codes, officialdom and the development of economic policy all play a part. The last chapter, a discussion of the evolution of the capitalist spirit, sums up Weber's account at a breathtaking pace. Neither the growth in population nor the inflow of precious metals from the New World is seen as decisive for the growth of capitalism. Geography, military requirements, the demand for luxury goods, the permanent enterprise, technology, rational systems of accounting, formalized and rational law are all cited and had been explored in detail in other works. The culmination of all this, Weber argues, was a rationalization of the conduct of life in general and of economic activity in particular. The main obstacle to rationalization was, and is, the sanctity of tradition which, for Weber, is by no means confined to the past and which is not overcome simply through economically rational action.

He had identified the power of tradition in the study of agricultural labourers and sought to account for its overcoming, first in his best-known work, *The Protestant Ethic and the Spirit of Capitalism* (1930 [1904–5]) and subsequently in the studies of world religions in *The Religion of China* (1951 [1916]), *The Religion of India* (1958 [1916]) and *Ancient Judaism* (1952 [1917]). In an age of faith, this overcoming required, given the immemorial strength of traditionalism, a major shift in beliefs concerning the proper course of human conduct under the eye of eternity. Concentrating on religious doctrines implied no view on their ontological status. Such matters lay outside the competence of social science. Nor did Weber suggest that

religious thinkers intended to promote the development of capitalism. The emphasis was much more upon the unintended consequences of the implications of theology for everyday life.

The key question was that of the Christian's calling or vocation in the world. Catholicism and Lutheranism were essentially traditionalist in relation to this issue. Divine providence has ordered things as they are; God has placed us in a particular station in life, therefore do not protest. Calvinism was, in Weber's view, cast in a different mould. The distinctive feature of this branch of Protestantism was the central place that its theology accorded to the doctrine of predestination. This doctrine, as set out in the Westminster Confession of 1646–8, asserts that God eternally decreed that some were predestined from before the foundation of the world to everlasting life and others to everlasting death. Moreover, that the numbers of the elect and the damned were immutably fixed and known only to God. Good works, while encouraged, could not, by virtue of the infinite distance between us and God, pardon sin nor draw us towards salvation. Weber sees this doctrine as unsustainable for the majority of believers. In an age of faith certainty of salvation was no idle question and here he argues that, in both pastoral care and in day-to-day life, the tensions engendered by predestinarian theology were addressed by the modification of attitudes to good works. These works remained unable to attain salvation, but true Christians could prove themselves (2 Corinthians 13: 5) and thus works appear in this context as a sign that one is a member of the elect. As Weber rather bluntly put it, God helps those who help themselves. The Protestant sect with its strict moral disciplines (particularly in relation to admission to the Lord's Supper) was accorded a key role in Weber's account of the carrying of this ethos into commercial and everyday life.

The upshot of this attitude, perhaps captured in some interpretations of the parable of the talents (Matthew 25: 14–30), turned into a life of unremitting work without the worldly pleasures of relaxation or ostentatious enjoy-

ment of wealth: a world now detached from mysticism, from the expression of the beauty of holiness in liturgical form and from the appreciation of the arts, lest idolatry, idleness or the wasting of precious time should creep into the believer's life. It was always needful to watch, work and wait, for the hour when the Lord would call the saint to account was not known (see Matthew 24: 42, 44; 25: 13). Clearly these matters are complex issues for biblical hermeneutics. Weber's suggestion was that hard work, cut off from the opportunity to enjoy the financial rewards of that work and driven by the most pressing of religious demands to fulfil one's duty in a calling, was a royal road to capital accumulation. It was also a route to the provision, as in Kidderminster during Baxter's ministry, of a workforce for capitalism. More than this, the injunction to master the self and to engage with and subdue the world for God provided the spirit or ethos which transcended traditionalism and opened the possibility of making money with a good conscience. This trait belongs, however, to a later age when the idea of a calling prowls about in our lives, as Weber puts it, like the ghost of dead religious beliefs.

Rationality and the process of rationalization

Much of this discussion is embedded in Weber's analysis of the disenchantment of the world. The reformed churches sought to rid the world of what they saw as magic and superstition, and in so doing continued a process which Weber traces back to the separation that the prophets sought between Judaism and the magic garden of polytheism in the ancient Near East. In this process of rationalization we have the basis for Weber's contrast between the civilizations of East and West. In neither India nor China, notwithstanding their achievements in mathematics, science and technology, does he find the activism that was significant for the development of capitalism. India, he suggests, was the home of an otherworldly mysticism while the Chinese masses were wedded to magical practices that, by virtue of the

emphasis on ritualized conduct, encouraged traditionalism. Even the Chinese elite, who in many respects orientated themselves to worldly interests, cultivated a 'gentlemanly' ethos not well suited to the pursuit of trade.

Vast as the scope of this comparative aspect of his work is, it remains only the tip of the Weberian iceberg in relation to the rationalization thesis. In the development of the capitalist enterprise, in law, accounting, the application of bureaucratic control, in the development of Western music, in science and education, in short throughout most of life, Weber is sensitive to the encroachment of RATIONALITY at the expense of tradition, charisma and enchantment. Rationalization is, then, central to Weber's thought and informs much of his work on the distinctiveness of Western culture. Precisely because of this centrality, an interpretation of the concept requires some caution.

It would be easy to judge the matter quickly and, unfortunately, superficially. Thus it might be thought that rationalization amounts to little or no more than a variation on either the doctrine of progress or on the supposed contrast between the civilized and scientific West and the rest of human society. The former view will not do, since Weber was opposed to the intrusion of philosophies of history, such as the belief in 'progress', into empirical analysis. It should also be said that the assumption of the doctrine of progress that we ascend from the worse to the better, from the kingdom of darkness to that of light, finds little support in Weber's work. In many respects quite the opposite is the case. Of course, there have been almost endless technical advances, but Weber has a strong sense of the potential meaninglessness of modern culture. There is no return to an older more 'complete' sense of identity for those who have eaten of the fruit of the tree of knowledge. The latter view is equally unsound since, important as the link to a scientific world-view is, Weber's concept of rationalization is by no means identical with it. He speaks, for example, of the rationalization of asceticism, mysticism and salvation doctrines in Indian religious life.

Finally, it is not the case that Weber's views

on rationalization (approximately the making of clear, systematic and structured arrangements for the pursuit of a given end) constitute a closed and deterministic system of thought. This point partly reiterates that made about his dislike of philosophies of history, but it is wider in scope. Weber's own philosophical assumptions include a central place for the concept of action and this is simply incompatible with an inexorable march towards a predetermined future. Of course we may, in practice, come close to a world in which so much seems beyond human control. We may be caught in capitalism's grip – an 'iron cage', 'a housing as hard as steel' as Weber puts it – but this cannot be known in advance. Indeed, quite the opposite is suggested in the closing passage of the discussion of the Protestant ethic. As befits a humanistic sense of agency, we may be caught but, equally, old ideas or new prophets may win the day.

Weber's contribution to social science

Seen in this way Weber's account of rationalization comes into contact with the controversies surrounding POST-MODERNISM. This is not the place to discuss these debates, but they are of such wide-ranging significance for social theory that they provide a way of trying to sum up the contribution that Weber makes to social sciences. Post-modernism is variously characterized as a radical form of social theory, as an incoherent and self-defeating assortment of ideas and as a critique of social science which seriously questions or destroys the very idea of these disciplines. Two themes stand out in the literature. One is the attack on the grand narratives that modernism is said to have inherited from the enlightenment. These 'meta-narratives' as they are usually called include, for example, ideas of progress, the Marxist and Freudian explanatory frameworks, and could include Weber's account of rationalization. In each, the body of work is held together by the unifying power of some overarching narrative such as the march towards a better world informed by the materialist approach to history or, more gen-

erally, by the inevitability of progress. The second main theme is the characterization of the passing of modernity as the passing of an age of clear agendas and of certainties, into one of doubt, fragmentation and relativism – precisely because the grand narratives have been cut away. Weber's view of rationalization does not seem to fall foul of these criticisms in so far as he is acutely aware of the ambiguities inherent in the concept itself and is also more than willing to see the human agent embedded in uncertainty, or in competing and even warring values. In many respects, then, Weber was remarkably prescient in relation to the claims of post-modernism. This is not to say that he belongs among them despite himself, or that his work is to be assessed primarily against some post-modernist yardstick. It does, however, suggest that his work is not readily overcome.

This is one of the central difficulties in trying to come to an overall view of Weber's contribution to the social sciences. It clearly cannot be the case that his ideas are immune from criticism. He would be the last person to suggest this in relationship to his own work or that of anyone else who accepted what he saw as the vocation for academic work. Critics have not been slow in coming forward. It is, nevertheless, the case that the scale and range of his substantive and conceptual analyses make any evaluation singularly difficult. At the very least, Weber draws on and contributes to virtually the whole range of disciplines and, in many respects, breaks down barriers between them. Although his interests stretch back into the earliest periods of recorded history Weber also explores issues that continue to resonate through the intellectual framework of social science. These are qualities that guarantee him an enduring place in the conceptual and empirical heartland of this intellectual enterprise.

See also:

Austrian School; bureaucracy; capitalism; class, definition of; class, Weberian approaches

to; determinism; legitimacy crisis; neo-Weberian approaches; society

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IVAN JAMES OLIVER

weighted voting

Several international institutions, such as the WORLD BANK and INTERNATIONAL MONETARY FUND (IMF), rely on voting systems that weight members' shares of votes according to some agreed criteria. Weighted voting systems have unique properties, because members' ability to influence outcomes do not derive straightforwardly from their percentage share

of the total votes. Many scholars have pointed out that voting weights – the percentage shares of votes – do not account for how each member can influence the formation of winning (or blocking) coalitions and therefore do not represent relative voting strength.

In other words, the number of votes held by a member is not always a precise indicator of that member's ability to affect outcomes. For example, consider a three-member committee that passes resolutions by simple majority with weighted voting, where two members have two votes each and one member has a single vote. Intuition would suggest that the third member has half as much influence as the first two members. Because passage requires three votes, however, the third member has as much voting power as the other two, on account of the mathematically possible number of coalitions. In short, voting weights do not adequately measure an actor's ability to affect outcomes, because weights neither account for the possible number of coalitions that may form, nor for the number of votes needed to pass a resolution.

Why would governing bodies be constructed with a weighted voting scheme? For the IMF and World Bank, it was recognized from the outset that some form of weighted voting would be necessary in order to appease the concerns of the members that were donating the majority of the capital. In other contexts, it may make some sense that a country with a very small population should not have the same influence as a country with a larger population. Indeed, this is exactly the case in the Council of the EUROPEAN UNION (EU). But, as suggested above, because of the unique characteristics of weighted voting systems, the assessment of how much formal influence each member has is not a simple matter. Thus, although weighted voting systems may seem appealing on the basis of apportioning votes among disparately sized members, there are consequences regarding how voting weights impact on voting strength. The effects of weighted voting further complicate the assessment of voting strength in some institutions because of the use of special (as opposed to simple) majorities. In the World Bank, for

example, a special majority of 85 per cent is needed to pass resolutions altering its Articles of Agreement. The use of special majorities can afford some members *de facto* veto power, because their votes are required for the passage of any resolution. Indeed, this is the case for the United States in the IMF and the World Bank on votes concerning such issues as the addition of new members. In short, when decision-making is conducted via weighted voting systems, one must be cautious in assessing the relative voting strength of actors.

JONATHAN R. STRAND

welfare

The concept of 'welfare' informs much international political economy (IPE). WELFARE ECONOMICS provides a benchmark for evaluating the EFFICIENCY of social systems of resource allocation. Economic welfare is conceived as the well-being of a community as a whole, but only as determined by individual preferences, aggregated into an ordinal social welfare function. This is supposed to express social preferences over different social states, characterized primarily by different allocations of resources, and the weight allocated to the satisfaction of different individual's preferences. The focus is on information about individual utility as determined by the consumption of COMMODITIES.

However, SOCIAL POLICY is generally acknowledged to be concerned with alleviating the multiple deprivations of POVERTY, homelessness, lack of access to health or education, lack of income and so on, which go well beyond any simple aggregation of the components of individual economic utility. Beyond adequate subsistence, welfare implicates at least, on one hand, economic independence and, on the other, some notion of what is 'good for' or 'needed' rather than merely what is 'wanted'.

The term 'welfare' in English dates from the fourteenth century. As the putative object of socially organized care, it first appeared in

1905. Political philosophy argues that welfare is necessarily grounded in some more fundamental concept of 'well-being' and so in notions of what constitutes the 'good life' – happiness, health and prosperity. The Aristotelian tradition insists that well-being spans the morally good as well as the (merely) enjoyable. This is argued to require freedom from unchosen deprivation or oppression, as well as a degree of individual autonomy, giving welfare an unavoidable political dimension. Economic 'welfarism' is inadequate, in practice, just to the extent that it is grounded only in utility information, neglecting broader ethical considerations.

For NEO-LIBERALISM, in particular, welfarism neglects concern for individual rights. Traditional liberalism insists on recognition of necessary ethically informed trade-offs between economic efficiency and individual rights. For neo-liberals, liberty is the most important element of well-being, transcending even material subsistence. The attack on welfare policy from the right tends to criticize welfare economics as a charter for motivationally inefficient and oppressive state intervention and personal dependence. Their critique implies that welfare is not too narrowly but too broadly drawn. The neo-liberal argues that all sources of 'enjoyment' have only a subjective import and that even moral principles are nothing more than (albeit especially ubiquitous and widely consensual) individual preferences.

Collective pursuit of welfare is then ideally to be confined to the procedure for identifying a constitutional mechanism (a rule) for social choice that could order all the relevant social states – on the basis only of all possible combinations of individual preferences over such states – in a liberal and consistent manner. KENNETH ARROW has, however, demonstrated that such a 'constitution' is impossible and the subsequent literature has debated which of the desirable ethical or logical characteristics that were assumed by Arrow could be given up to generate a feasible and stable 'second-best' social choice procedure (see SECOND BEST, THEORY OF).

The radical left argue that the liberal position neglects the structural constraints on individual autonomy necessary for efficient market capitalism. KARL MARX insisted that, *pace* ADAM SMITH, individuals had no natural propensity to truck and barter, only a socially conditioned disposition to do so in appropriate contexts. Social and economic policy ultimately cannot abstain from social value judgement over the distribution of access to welfare and the power to affect that distribution. Thus welfare policy cannot be reduced to the outcome of a cost-benefit study that approves those measures that may be expected to make the gainers so well off that they could in principle compensate the losers. The pursuit of welfare involving, as it must in practice, redistribution and the presumption that society may sometimes override the preferences of individuals (as in benefits in kind and in compulsory education, health and pension provision) implies the existence of social value judgements on welfare that go beyond individual preferences, however aggregated.

The subordination of principles to preferences is a specifically liberal ethical position. It is ethically neutral only assuming the absence of significant persistent conflict between the preferences orderings of different groups. Arrow's paradox arises just because it attempts to derive cooperation only from the aggregation of radically individualistic preferences. Ethical norms that transcend individual preferences (if only in order to defend their primacy), in response to which WELFARE CAPITALISM has evolved, are embedded in the structures of capitalist society. They include the liberal reduction of principles to individual preferences itself, as well as the bourgeois notion that the prime basis for justice resides in the interests of property owners, leaving the propertyless to the mercies of private charity.

It is widely agreed that the distribution of access to life's chances thrown up by markets requires some justification or amelioration. For welfare economics, incentives seen as bribes to invoke economically efficient action cannot thereby also reflect any notion of just desserts. Free markets give individuals neither what they

welfare capitalism

deserve nor what they need, but only what is required to induce them to contribute to economic activity.

The conflict between welfare-as-subsistence in terms of individual utility and a broader concept of well-being involving notions of autonomy, freedom and justice, is perhaps endemic to the capitalist economy. The modern welfare capitalist state both has to address welfare and is faced with the consequent violation of the efficiency of the market capitalist economy, on which it is fiscally dependent. This is a social tension that state policy may manage, but cannot (short of social systemic change) overcome.

See also:

economic policy, national; Hayek, Friedrich August von; Kaldor, Nicholas; Mill, J(ohn) S(tuart); Sen, Amartya Kumar; social policy; welfare state

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MICHAEL WILLIAMS

welfare capitalism

'Welfare capitalism' may be defined in two ways: as a type of CAPITALISM (1) that ensures minimum standards of income, nutrition, health, housing and education to every citizen as a social right or (2) in which governments intervene, as advocated by JOHN MAYNARD KEYNES, in the economy to ensure adequate levels of investment and domestic income as a way of regulating BUSINESS CYCLES. These two definitions are interrelated, in so far as welfare capitalism seeks to generate a level of national income sufficient to finance a certain level of social security that is justified on ethical grounds.

Although there had always been a regular flow of public expenditure, such as on roads and on schools, welfare capitalism in the United States may be said to have begun with the New Deal programmes introduced by President Franklin D. Roosevelt in the 1930s. The GREAT DEPRESSION of the 1930s had demonstrated that markets do not always work when left alone. The New Deal really started a new relationship between the government and the private economy, in which the government was to be re-conceived as a permanent stabilizing and growth-promoting agency for capitalism as a whole: government would ensure a certain level of employment and output, and provide income support to groups deemed to be at risk in the market.

Welfare capitalism, however, was firmly established in Western societies only after World War II. Following the war, the public sector became a major component of the capitalist economy. One can identify four key areas of public intervention in the post-World War II period. The first area is intervention related to the family and the raising of children, including healthcare, public education, as well as subsidized childcare, child/family allowances, food stamps and transfer

payments to single mothers. The second area relates to the labour market, including minimum wage, retirement age, education/training, injury insurance and so on. The third area is related to labour-capital relations, including collective bargaining rights, employment and safety standards. The fourth area is related to life after retirement, including old-age pensions, as well as social assistance to those who are unable to work.

There are, however, considerable variations in the degree to which capitalist economies in the West became government-oriented. The United States has always had a relatively modest public sector as compared to countries like France, the Netherlands, West Germany and many other countries. For example, in the United States, programmes of health, public housing and child allowances are not as highly coordinated or as well-funded as they are in many European countries. Many more programmes in Europe are universal, open to everyone, rather than being available only to the very poor. In fact, the United States is unique among industrialized countries in having no government-sponsored medical programme for every citizen.

As welfare capitalism was established in the post-war period, Western countries experienced unprecedented levels of economic growth. For the industrial countries as a group – the ORGANISATION FOR EUROPEAN ECONOMIC CO-OPERATION (OEEC), Canada, Japan and the United States) the average increase in GROSS DOMESTIC PRODUCT (GDP) per person from 1959 to 1973 amounted to about 4.5 per cent per year. The term 'economic miracle' was first used to refer to the unusually high rates of growth in West Germany throughout the 1950s and 1960s. And Germany was not alone: growth 'miracles' abounded during this period. From the 1950s until 1974, unemployment rates for ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries as a whole were less than 3 per cent. It appeared that welfare capitalism countries had finally resolved the historic conflict between the richer and poorer classes. This type of 'guided' or

'Keynesian' capitalism (see KEYNESIAN ECONOMICS) really seemed to have all the answers. If the economy was sluggish, the government would simply boost spending or cut taxes, leading to temporary deficits until the economy grew again. If workers were laid off, unemployment insurance would permit them to maintain spending. If demand rose too fast, pressuring prices upwards, the government would raise taxes or cut spending. The 'end-of-ideology' arguments that became popular in the 1950s and 1960s reflected this optimism for a reformist end to class society.

But the post-war boom slowed down in the 1970s. Unemployment and INFLATION both rose. Soon, governments were short of funds. They first had to borrow money to maintain social programmes. Then they had to borrow just to pay interest on the existing debt. By the early 1980s, welfare capitalism was under full attack. Right-wing parties, such as those led by Margaret Thatcher in the United Kingdom and Helmut Kohl in West Germany, as well as the Reagan administration in the United States, set out to reduce levels of welfare expenditure in their countries. Even in states led by socialist governments, in Australia, France, New Zealand and Spain, provision of public benefits was cut back.

Led by MILTON FRIEDMAN, a new economic movement called 'MONETARISM' argued that the troubles of the 1970s were the result of the Keynesian interventionist state itself. According to Friedman, the appearance of STAGFLATION in the 1970s (that is, a stagnant economy combined with high inflation – a combination which should not occur according to Keynes's theory) had undermined the idea that government borrowing could ensure sustained growth and full employment. Friedman argued, along with other conservative economists, that only monetary policy affects the long-run level of economic activity and that the efforts of governments should be directed at controlling inflation by controlling the supply of money (see MONETARY POLICIES). To control inflation, the government needs to reduce spending, which causes INTEREST RATES to rise and leads to a fall in investment by the private sector.

welfare economics

More importantly, Friedman argued, rising taxes are required to pay for rising government expenditure, thus undermining private incentives to work and invest. Indeed, the very ethical rationale of welfare provision was condemned by conservatives on the grounds that such provision produces a dependency culture which is quite detrimental to good citizenship. Some critics even linked the breakdown of traditional family structures and the rise of illegitimacy to government benefits for unmarried mothers.

The left has also put forward many arguments to explain the 'crisis' of welfare capitalism. An argument which is gaining a lot of credibility is that the attack on welfare capitalism by the 'New Right' is the political expression of the GLOBALIZATION of capitalism. This globalization has involved (1) removing barriers to FREE TRADE and free capital movement, (2) locating each part of the production process where the costs are lowest, (3) using advanced microelectronics and computer-integrated systems, and (4) hiring fewer full-time workers and more part-time, seasonal and contract workers. Capitalism can now operate wherever taxes and wages are low. Workers, however, are far less mobile and, as a result, are forced to accept lower wages in order to attract investment into their localities. Government macro-economic policies must also be compatible with the regional and global movements of capital, unless a national government wants capitalists to locate their operations elsewhere. The economic foundation on which welfare capitalism rested has been eroded, forcing national economies to accept what global capital requires: the 'New Right' agenda.

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RICARDO DUCHESNE

welfare economics

The role of welfare economics is the evaluation of different economic situations and policies on the basis of their contribution to the economic welfare of the community. It is thus concerned with questions that are *normative* (what should be) rather than *positive* (what is). Welfare in this context refers to well-being, not to social welfare programmes such as unemployment benefits. In the following paragraphs, some of the main issues in welfare economics are illustrated, using examples from the economics of international trade.

Defining the economic welfare of a community or economy is difficult, particularly when it involves aggregating the well-being of different individuals. To avoid the interpersonal comparison of individuals, economists commonly use the concept of Pareto efficiency (see EFFICIENCY). An economic outcome is said to be Pareto-efficient if it is not possible to make any individual better off without making any other individual worse off. Put simply, there is no surplus which can be given to some people without taking from others. This criterion of economic efficiency forms the basis for a simple test of economic policies: if the beneficiaries of a particular policy change can compensate those who lose from the change and still be no worse off themselves, then the policy change is said to result in greater economic efficiency in the Pareto sense. Policies which lead to less economic efficiency are termed 'distortions', because they 'distort' both

production and consumption away from their Pareto-efficient levels.

An example: the gains from trade

A good illustration of these principles is found in the argument for free international trade. If an economy which has previously been closed to trade from the rest of the world is suddenly allowed to trade with other countries with different relative production costs, it can increase its national income by moving productive resources into those goods where its relative costs are lower and out of those goods where its relative costs are higher (see **COMPARATIVE ADVANTAGE**). This reallocation of resources allows the country to specialize more effectively and thus produce more with the same resources. In addition, the economy also increases its consumption possibilities by being able to buy goods produced at lower cost in other countries. As part of this process, the country's export sectors will gain from being able to sell more of their goods to the rest of the world and consumers will gain by being able to buy a larger quantity of imported goods at a lower price. However, there are also losers from the change. In this case, they are the owners of factors (capital, labour and land) in the import-competing sectors. Thus, the move from **AUTARKY** (no trade) to **FREE TRADE** has clear winners and losers. However, economists have shown that, in the case of competitive markets, the gains to the beneficiaries of free trade will exceed the losses to those who are hurt by the change, meaning that the winners have sufficient to compensate the losers and still be ahead themselves. Thus, free trade is seen as being more efficient than autarky – some can be made better off without making anyone worse off. In essence, the ability to trade expands the economy's production opportunities – it can produce a given commodity domestically (as under autarky) or it can 'produce' it by trade, exchanging some other domestically produced good for it on world markets.

In practice, there can be problems implementing compensation, in which case the losers may be inadequately compensated or not

compensated at all. Because of the resulting change in income distribution, some groups in the community may be vocal opponents of policy changes which are beneficial for the community as a whole (that is, are efficient). It is therefore most important when policy changes are proposed, that a clear distinction be made between the distributional and efficiency effects of the change and that a clear programme of compensation be announced. An important practical difficulty in deciding how much compensation to pay is that those who are hurt by a policy have a strong incentive to overstate their losses in order to secure higher compensation. This 'incentive-compatibility' problem is one reason why governments tend to err on the side of under-compensation.

The welfare cost of trade restrictions

In practice, economists are faced with estimating the welfare consequences of various government policies which partially restrict trade. A common example is a **TARIFF** or duty on imports. A tariff causes the domestic price of imports to rise above their landed duty-free price. This will also lead to an increase in the price charged by domestic firms to domestic consumers. This implies three main effects from a welfare point of view:

- 1 because of the increased price, domestic consumers will buy less of the importable good – they lose from the tariff;
- 2 the higher domestic producer price will stimulate domestic output of the good(s), causing factors in the domestic import-competing sector to gain from the tariff;
- 3 the tariff yields tax revenue and so benefits taxpayers.

It is a well-known result of international economics that if the country imposing the tariff is 'small' (in the sense that it cannot influence the prices at which it trades with the rest of the world – its **TERMS OF TRADE**), then the losses to consumers outweigh the gains to the import-competing sector and taxpayers,

implying that the tariff represents a fall in efficiency. This loss of efficiency, which is also referred to as the 'welfare cost' or 'deadweight loss' of a tariff, may be understood in another way. A tariff increases domestic price and reduces consumption, thus causing a loss of well-being to consumers. This fall in consumption is also reflected in a fall in imports, thus saving the economy foreign exchange. However, because the value that consumers place on the foregone units exceeds what it cost to import them, there is a net welfare loss. On the production side, the cost to the economy of extra domestic production exceeds the cost of the imports displaced by that production, so there is another net welfare loss. The sum of these consumption and production effects is the overall welfare cost of the tariff.

This welfare cost is readily estimated for any industry using simple information about the industry's demand-and-supply curves. More precise estimates of the deadweight loss of a tariff system may be obtained using a full GENERAL EQUILIBRIUM model, which takes into account relationships between different markets in the economy. The welfare cost of tariffs in ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries at the time of the Tokyo Round of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) in the 1970s was generally agreed to be less than 1 per cent of GROSS DOMESTIC PRODUCT (GDP).

Distortions and reform

Modern economies are typically beset by a whole range of distortions (taxes, SUBSIDIES, QUOTAS, price floors and ceilings, and so on) across different markets. The simple reasoning used in the above tariff illustration then breaks down. We are then in the world of the 'second best' (see SECOND BEST, THEORY OF), in which removing a single distortion while leaving other distortions unchanged may actually reduce welfare. This paradox is readily understood using an example in which the only distortions are tariffs on imports of beer and wine. If there were only a tariff on beer, its removal would

raise welfare. However, in the presence of an unchanged tariff on wine, the removal of the beer tariff causes a large switch in demand from wine to beer. As a result of this substitution, wine imports fall and beer imports increase. The rise in welfare associated with the removal of the beer tariff must now be weighed against the loss of tariff revenue on the reduced wine imports. If the latter effect dominates, total economic welfare would fall. If there were no tariff on wine, then this substitution between goods would be unimportant. Obviously things are far more complicated in real-world economies characterized by the full range of distortions.

Faced with these problems, economists began looking for simple rules which would enable them to predict if a particular package of reforms would raise welfare, even when some distortions were left unchanged (perhaps for political reasons). The resulting literature has suggested two classes of 'piecemeal reform' rules that predict the raising of welfare under certain conditions. The first of these is the 'uniform reduction' rule, which involves reducing all distortions in the same proportion (for example, all tariffs come down by 10 per cent). The other is the 'top-down, bottom-up' or 'harmonization' rule, which involves reducing the highest and/or increasing the lowest distortions. This latter rule reflects the idea that non-uniformity of distortions reduces welfare.

Non-economic objectives

Introduction of distortionary policies is usually driven by political economy considerations. Indeed, there is an extensive literature explaining the pervasiveness of policies which benefit small, well-organized lobbies at the expense of the majority of the population (see POLITICAL ECONOMY). However, the focus of the government in these situations is usually some key economic variable such as employment. The relevant question then is: Which policy achieves the desired target at lowest welfare cost? The literature on such 'non-economic objectives' tells us to use the policy that directly affects the target variable. Thus, if the objective

is to limit imports of a good, a tariff should be used; if the objective is a target level of employment, an employment subsidy is best, and so on.

See also:

commercial policy (CP); protection costs; trade policy

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NEIL VOUSDEN

welfare state

Societies in which some groups have systemically inferior access to the reciprocal benefits of market participation are faced with the problem of reconciling democracy with a distribution of social surplus that is unequal and may be inequitable. The welfare state is a constituent part of the liberal settlement between political democracy and the capitalist economy (see CAPITALISM). While most state action will have welfare effects, many of them intended, welfare policy more narrowly conceived is directly concerned with the well-being of citizens. It entails provision that is rights-based, collective and often compulsory.

With the evolution of the capitalist economy and democratic polity, the communal and kinship relations that had earlier ensured provision for the economically inactive gave way to a politicized welfare management. The material basis of social existence under market capitalism is, in the last resort, labour income. Wage labourers, by definition, have no significant capital to cover unemployment, sickness and old age. The capitalist economy in

itself is indifferent to the existence of particular individuals and entails dynamic tendencies that periodically undermine the conditions of that existence. The welfare state is a response to the needs of modern society characterized by industrialization, rapid TECHNOLOGICAL CHANGE, urbanization, fragmentation of community and family, increased division, sectoral and geographical mobility of labour, and decreased paternalism in the workplace. It is increasingly as citizens (and decreasingly as private individuals or employees) that people claim rights to adequate social existence. Communitarity now resides primarily neither in the private sphere of kith and kin, nor in a CIVIL SOCIETY that has been given over to impersonal market forces, but in the welfare state.

The prehistory of the modern welfare state is marked by the evolution from liberalism's notions of personal responsibility for management of the risks of contingent, particular, individual existence, to its collectivization and then socialization. The provision of public elementary education starting in Europe in the mid-nineteenth century and the British Factory Acts (1833–53, 1874, 1878), Working Men's Compensation Act (1879) and Public Health Acts (1848–1975) prefigure the welfare state. Overt welfare policy appeared in Europe first in Bismarck's social insurance schemes in Germany in the 1880s, which evolved into the *Wohlfahrtsstaat* of the 1920s. The term 'welfare state' first emerges in English in 1939, though recognizable welfare policy dates from 1905. The arrival of the welfare state proper in the United Kingdom is marked by the Beveridge Report (1942) – advocating social insurance and universal benefits to alleviate contingent absolute deprivation of specific basic goods and services – that resulted in the 1944 Butler Education Act and the Social Insurance White Paper. Significant welfare policy first emerged in the United States in the 1930s, under Roosevelt's 'New Deal' response to the GREAT DEPRESSION. Major expansion of welfare expenditure in the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries followed each of the two

world wars and continued into the mature post-war KEYNESIAN corporatist settlement of the 1960s and 1970s (see KEYNESIAN ECONOMICS). By the late 1970s, average expenditure on social policy in the advanced capitalist countries had stabilized at almost a third of GROSS NATIONAL PRODUCT (GNP) and half of total government expenditure.

Welfare policy normally includes support for a minimum family income, reduction of insecurity by help in contingencies such as sickness, unemployment, disability and old age, and facilitation of universal minimum standards of healthcare and education. Cash benefits to individuals (social insurance, social assistance, universal benefits) are typically supplemented by services in kind – public health, healthcare, education, housing and personal social services. Welfare protection is also afforded through state regulation of health and safety at work and in the home, consumer safety and minimum wages, as well as the incorporation of employers' federations and trade unions into policy formulation.

Fully-fledged welfare states are primarily a twentieth-century phenomenon. The Beveridge principles were soon eroded. Neglect of the precise politico-administrative managerial mechanisms that were to replace market regulation for decommmodified welfare services, especially in the light of *de facto* gradual withdrawal from commitment to full employment, was by the late 1970s becoming obvious. Despite fiscal 'crises' and close attention by policy-makers to welfare reform, there was little sign of significant secular decline in the proportion of resources devoted to welfare (see FISCAL CRISIS). However, by the end of the twentieth century, the socialization of risk that had informed the prehistory of the welfare state was under attack, to be replaced (it was argued) by a more limited provision of information adequate to facilitate its individual management, with a minimal means-tested welfare safety net.

Both the radical left and neo-liberals have seen the expansion of the welfare state as involving significant 'decommmodification' of the crucial goods and services whose supply it

manages, diluting the market regulation of the capitalist economy upon which the state is fiscally dependent. The demands on the welfare state tend to be greatest during economic recession, when the economy is least able to fund them. For NEO-LIBERALISM, it is illegitimate for the state to enhance the welfare of those to whom nature and the market has dealt a poor hand. It should at most rectify earlier procedural injustice. The modern state, neo-liberals argue, can only avoid infringing liberty by supporting market coordination of human affairs and itself acting only strictly in accordance with the rule of law. A radical left analysis of the contradictory imperatives of the capitalist welfare state argues that policy in pursuit of the right to adequate social existence may conflict with the right to property. Some Marxists appeal to a notion of procedural justice to argue that market outcomes are legitimately fungible because CAPITALISM rests on a prior primitive accumulation involving forcible expropriation of peasantry and artisans. Once even a minimal legal, monetary and infrastructural state framework is conceded, the state's fiscal dependence on wealth creation in the market economy means that it inevitably dilutes property rights – first by levying taxes, then by being drawn into macro-economic management followed by micro-economic intervention in pursuit of economic stability and growth.

Many welfare policies entail at least some degree of compulsion. Welfare beneficiaries must submit to economic and social strictures that the well-to-do are free to violate. While citizens may accept the state as protector of their rights to property and social existence, its activities – specifically taxation – are inevitably experienced as impinging on the former. The welfare state is thus impelled to legitimate its actions by reference to desirable social and economic outcomes. This may tend to undermine the separation of economy and polity upon which the legitimation of liberal market capitalism seems to rest. Reference to rights and duties (over and above any consequences) have typically been used by neo-liberals to criticize welfare states for developing proce-

dures that systematically infringe individual liberty and private property. For traditional liberals, we can demand from society not particular outcomes, only equal opportunity. Neo-liberalism argues that welfare policy will be captured by RENT SEEKING special interests empowered by the principal-agent problems associated with a political and administrative structure of myopic utility-maximizing voter-consumers, vote-maximizing politicians and budget-maximizing bureaucrats, generating excessive growth of expenditure in relation both to tax resources and economic efficiency. 'Welfarism' is criticized for engendering unrealistic rising expectations, MORAL HAZARD and adverse selection, paternalism, unsustainable expense, inflationary pressures, burgeoning centralized bureaucracy and public debt, as well as an expansion of economically unproductive labour and economic disincentives.

The tensions inherent in welfare state structures have made reform difficult. Neo-liberal attempts to restrict welfare policy to cash redistribution through a negative income-tax system would undermine ethical legitimization of the welfare state. Nothing follows merely from the premise that some people have less money than others – nothing follows, without reference to relative multiple deprivation in terms of specific goods, services and opportunities deemed necessary for adequate social participation. The typical welfare-state notion that old age is an unforeseen contingency reveals starkly the lack of any actuarially sound underpinning of social insurance. In effect, the socialization of risk is at the same time its de-actuarialization, since those unable to sustain an adequate social existence by marketing their labour power are unlikely to be able to contribute to actuarially sound insurance funds. This does not bode well for reforms based on substituting private insurance for welfare policy. Attempts to re Commodify welfare services are often complemented by the return of those aspects resisting re Commodification – the care of the elderly, young and disabled – to the community, private charity and the family.

The alleged negative economic effects of

welfarism are not well supported by empirical evidence. The welfare state contributes to social, economic and political stabilization. It leaves largely undisturbed the prerogatives of capitalist investors and managers. There is little evidence of fundamental redistribution of either income or power from capital to labour. Welfare states seem concerned both with free will and humanity, and the moderation of market capitalist outcomes that may infringe basic human rights. The neo-liberal solution leaves society at the mercy of the contradictions of the capitalist economy. On the other hand, SOCIAL DEMOCRACY is faced with somehow managing the tensions of the welfare state and the mixed economy.

See also:

Arrow, Kenneth; corporatism; Friedman, Milton; legitimacy crisis; minimalism (political); public choice (PC) theory; Smith, Adam; Weber, Max; welfare capitalism

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West African franc zone

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MICHAEL WILLIAMS

West African franc zone

The West African franc zone (along with the Central African franc zone) makes up the African franc zone or COMMUNAUTÉ FINANCIÈRE AFRICAINE (CFA) – a monetary area covering France's former colonies that was formally created in 1939. The zone consists of fourteen members, thirteen of whom are former French colonies: Benin, Burkino Faso, Cameroon, the Central African Republic, Chad, Congo, Côte d'Ivoire, Equatorial Guinea, Gabon, Guinea-Bissau, Mali, Niger, Senegal and Togo. The Comoros Islands also participate. The currency of the zone is known as the CFA franc and is used by around 80 million people throughout the area. Formerly tied to the French franc, after a EUROPEAN UNION (EU) agreement in 1998 and France's accession to the single European currency, the CFA franc is now tied to the euro (although it remains a separate currency).

Despite the role that France has played as an anchor currency over the years, the CFA franc

has undergone periods of uncertainty. Perhaps the most significant of these was the devaluation of the CFA franc by 50 per cent in 1994, following over forty years of being tied to the French franc at the same rate. Analysts remain undecided as to the impact that the single European currency will have on the CFA franc's value.

In recent years, countries in the African franc zone have demonstrated their interest in regional INTEGRATION by formalizing their traditional division into two distinct groupings: the West African Economic and Monetary Union (UEMOA), consisting of Benin, Burkino Faso, Guinea-Bissau, Côte d'Ivoire, Mali, Niger, Senegal and Togo, and the Central African Economic and Monetary Community (CEMAC). The UEMOA embarked on a full economic union in January 2000.

See also:

decolonization

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ALISON M.S. WATSON

Western European economy

The birth of a Western European economy begins with the end of World War II, when the advent of the COLD WAR determined the separation of Europe into two opposing political and economic blocs. Over the decades, the notion of a Western European economy evolved, following the transformation of a series of independent national Western European markets into a group of highly integrated economic partners. Despite differences in the political and economic interests of the various Western European countries, this process of economic INTEGRATION appears irreversible and destined to transform Western

Europe into a powerful single economic actor able to compete on the international scene.

The formation of what is now the world's largest trading area, with the highest GROSS DOMESTIC PRODUCT (GDP), can be traced to the 1950s. At this time, several Western European nations agreed to create common supranational institutions, with the purpose of strengthening international relations and promoting socioeconomic prosperity among their member-nations. The implementation in 1957 of a CUSTOMS UNION (CU) through the creation of the EUROPEAN ECONOMIC COMMUNITY (EEC) and the establishment in 1960 of a EUROPEAN FREE TRADE ASSOCIATION (EFTA) by several European countries, were critical institutional steps on the path to the area's economic coordination. The realization of an integrated Western European economy continued over the decades with the progressive enlargement of the EUROPEAN COMMUNITY (EC) and its successor, the EUROPEAN UNION (EU), to include all but four Western European nations (Iceland, Liechtenstein, Norway and Switzerland). The creation of the EUROPEAN MONETARY SYSTEM (EMS) in 1979, the ratification of the MAASTRICHT TREATY in 1991 and the subsequent introduction of the ECONOMIC AND MONETARY UNION (EMU) in 1992, all played a fundamental role in the creation of an unrestricted Western European economic area with free circulation of individuals, goods and services. In 1999, eleven of the now fifteen EU members adopted a European single currency, the euro, coordinated by a common European Central Bank. This further expands the level of economic integration of the area, creating the *de facto* conditions for a single Western European economy.

Despite the importance of the process, divisions still remain among several Western European countries, accompanied by cyclical periods of economic expansion and crisis. In the absence of a coordinated economic policy at the EU level, national and international differences in political and economic orientation still pose serious limits to a truly unified Western European economic zone. In addition, as the trend of EU expansion continues and

starts to affect the transition to capitalism in Eastern Europe, the notion of a Western European economy may well lose its present definition. The future EU enlargement to Eastern European countries may pave the way to a reconfigured geopolitical as well as economic European scenario.

See also:

European Union, eastern enlargement of the

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STEFANO DOMINIONI

Westphalia, treaties of

In 1648, three treaties were signed in two towns within the German territory of Westphalia. The first, in the city of Münster, ended the war between France, the Holy Roman Emperor and their respective allies; the second, also signed in Münster, brought to an end the Eighty Years' War between Spain and the Netherlands; finally, the Treaty of Osnabrück, brought peace between the Emperor, Sweden and their allies. The war between Spain and France would drag on for another eleven years, before ending in

Westphalia, treaties of

the Treaty of the Pyrenees in 1659. From a purely power-political point of view, the treaties did little to change the pre-war power relations of Europe. France had reasserted itself as a major force in European politics, but Austrian and Spanish Habsburg power was not greatly diminished. Spanish decline was to occur after 1648. Smaller states, such as Brandenburg and Bavaria gained territory, while Sweden began a short-lived period as the dominant power in the Baltic. In the Low Countries, the Dutch and Spanish finally recognized the division of the Netherlands and the Empire recognized the creation of the Swiss Confederation. Finally, the states of the Holy Roman Empire had their freedom from imperial control confirmed. Little had also changed in the confessional divisions of Europe, with the glaring exception of the collapse of the Bohemian Protestants. A contemporary of the treaty could be forgiven for feeling that a long war had been fought merely to confirm the political and religious arrangements that had been the cause of the war in the first place.

While the territorial rearrangements of the treaties of Westphalia hardly seemed to justify thirty years of almost constant warfare, the institutional implications of the treaties were to define key areas of the relations of states for the next three-and-a-half centuries. To a certain extent, however, there was nothing new in these institutional provisions, many of which were merely reaffirmations of the Peace of Augsburg (signed in 1555). At Augsburg, the main Lutheran and Catholic princes of Germany had agreed to a compromise formula by which the religion of the prince should also be the accepted religion of his subjects (*cuius regio eius religio*). This policy was reaffirmed in Westphalia with two amendments. First, the Calvinists were also included in the compromise and, second, the Augsburg formula was interpreted as referring only to public life and thus the principle of private religious worship was accepted. The acceptance of the Augsburg formula was a recognition by the major states of Europe that religious questions should no longer be of primary importance in relations

between states. The net result of this was the recognition of a crucial difference between inter-state and domestic politics. Domestically, a government was justified in imposing homogeneity in religion, while internationally it was required to accept difference. The importance of Westphalia in the settlement of confessional divisions, therefore, was not in the novelty of its prescriptions, but rather that its articles were successfully implemented. In this sense, Westphalia could be seen as being Augsburg for slow learners.

Although the treaties of Westphalia did not expressly advocate the primacy of the secular state in the new emerging European order, they certainly did accept the emergence of the STATE and the principle of *raison d'état*, at least implicitly. The compromise over religious differences proved to be a lasting confessional peace, which left the major states of Europe to concentrate on issues of self-preservation and conflicts over territory. The major signatories and guarantors of the new peace were all recognized sovereign states, rather than religious groups or city and borough authorities. The pope, for example, was left to denounce the treaties from the outside, while many in the Protestant Bohemian churches felt a sense of betrayal. In this sense, the treaties reaffirmed the importance of the concept of SOVEREIGNTY as a precondition for recognition as a diplomatic entity.

In the short term, the Westphalian compromise encouraged greater internal conflict and disorder among some of the signatories. In France, for example, the implementation of the Augsburg formula involved the revoking of the Edict of Nantes, which had been the basis of the compromise peace between Catholics and Protestants. In effect, the price of peace between sovereigns was the acceptance of the right of a government to behave as it pleased domestically and consequently for a government to be the moral conscience of its people. This central element of the Westphalian compromise was to be challenged by liberals in the nineteenth century, who saw it as morally and rationally repugnant. Indeed, the conflict between the rights of sovereign governments to

act as they please in their own territories and rights based on cosmopolitan and humanitarian ideals remains a major irritant within international relations (IR) and international political economy (IPE) to this day.

Although the Peace of Westphalia has been rightly seen as a fundamentally conservative compromise, in which an exhausted Europe accepted the status quo, the means used to reach that compromise established a pattern for inter-state behaviour that still affects IR today. The development of the idea of sovereignty was not only a recognition of the growing power of the absolutist state, it was also a prescriptive formula. Sovereign states were increasingly regarded as the only legitimate actors in international politics and the idea that the world was divided into recognizable monolithic territorial states became a basic assumption of political life. By the twentieth century, this political arrangement became known as the Westphalian system in honour of the treaties that were believed to have given birth to it, and it was contrasted with various transnational and functional models that offered alternative ways of arranging international politics.

LUCIAN M. ASHWORTH

women in development (WID)

Until the 1970s, DEVELOPMENT theories and practice (like most of the social sciences) largely ignored the position of women. However, the publication of Ester Boserup's *Women's Role in Economic Development* (1971) was important in marking a change. She used existing data to document the division of labour in agricultural economies, arguing that women do most of the work. In more densely populated regions where farmers had access to more technology, men dominated agriculture; in areas of intensive irrigation-based agriculture, there was a more even division of labour between men and women. Boserup claimed that women were not recruited to the 'modern' sector and were consequently unable to benefit from development. Her solution was two-fold:

first, to change the attitude of governments and development agencies so that women could be given access; second, to implement a massive programme for women's education, which she saw as the prerequisite for all other forms of advancement (Boserup, 1971). Liberal feminists in the United States adopted the term 'women in development' (WID) and pressed for legal and administrative changes to integrate women into economic systems. WID was closely associated with the modernization paradigm in development studies (see MODERNIZATION THEORY), which used a simplistic view of industrialization, the benefits of which were expected to TRICKLE-DOWN to all parts of society. The approach was also linked with 'human capital' policy approaches advocating massive investment in education systems (Rathgeber, 1990).

The advocates of WID established that women's experience of development and social change differed from that of men. It was possible to demonstrate statistically that women benefited less than men from the development strategies of the 1950s and 1960s. WID supporters advocated the development of appropriate technologies that would lift the burden of heavy work from women. However, critics pointed out that men tended to appropriate new forms of technology regardless of who had been previously responsible for particular tasks. WID approaches accepted existing social structures, focusing on how women could be better integrated into existing development initiatives and advocating their equal participation in education, employment and other spheres (Jackson and Pearson, 1998).

This ran counter to the questioning of the sources and nature of women's subordination and oppression current in much feminist social science of the time. WID was criticized for ignoring the insights of critical perspectives such as DEPENDENCY THEORY or Marxist/neo-Marxist approaches (see MARXISM—LENINISM; NEO-MARXISM). It was seen by many as ahistorical and tending to ignore differences between women (of class, generation, ethnicity and culture), overlooking the relations of EXPLOITATION that exist between women.

World Administrative Radio Conference (WARC)

WID also focused exclusively on the money-earning or 'productive' aspects of women's work, ignoring or minimizing their reproductive roles. Its basic assumptions derived from liberal feminism: that women's position will automatically improve as they participate more fully in the formal economy.

By the early 1990s, most international development agencies were encouraging developing countries to establish formal WID strategies, setting up special funds for activities relating to women and advocating their employment in the public sector. These strategies did not challenge the social relations of gender or propose more fundamental social change. The WID approach did not tackle existing patterns of inequality (such as the distribution of land or wealth within societies) or the sexual division of labour within households (see DIVISION OF LABOUR, SEXUAL). They failed to question the international dimensions of inequality or the social construction of GENDER that undervalues the domestic realm.

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CATHIE LLOYD

World Administrative Radio Conference (WARC)

The World Administrative Radio Conferences (WARCs) of the INTERNATIONAL TELECOMMUNICATION UNION (ITU) were responsible for allocating the radio-frequency spectrum to particular uses and revising the Radio Regulations. The radio part of the electromagnetic spectrum ranges from extremely low frequen-

cies used for submarine communications, through the familiar broadcasting frequencies for AM and FM radio and for television, to the super-high frequencies used in satellite communications. International agreement on allocation is necessary to avoid interference between different users and to apportion what is sometimes a scarce resource. The assignment of specific frequencies to broadcasting, communications or other operators within the allocations worked out by the WARC was a matter for the International Frequency Regulation Board, which generally acted on a 'first come, first served' basis. General WARC's, which allocated the entire radio spectrum, were held at twenty-year intervals. The last such meeting occurred in 1979.

JOHN VOGLER

World Bank

The World Bank is a multilateral development institution whose stated purpose is to assist developing member-countries in furthering their economic and social progress. It comprises two legally and financially distinct bodies: the International Bank for Reconstruction and Development (IBRD) (established in 1945) and INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA) (established in 1960). Their functions are to lend funds, provide economic advice and technical assistance, and to act as a catalyst to investment by others. Affiliated organizations are the INTERNATIONAL FINANCE CORPORATION (IFC) (established in 1956), which has been called the 'leading private-sector aid agency in the world' (Ryrie, 1995: xiv), and the Multilateral Investment Guarantee Agency (established in 1988), which aims to protect direct foreign investors (see FOREIGN DIRECT INVESTMENT (FDI)) from non-commercial risk, especially risk of WAR.

The IBRD borrows in world capital markets and, because of its favourable credit rating, can lend at very competitive rates. The IDA, which lends on highly concessionary terms to the poorest countries, has annual net disburse-

ments of around US\$5 billion. It relies mainly on subscriptions from the richer member-governments. The World Bank makes annual gross lending commitments of over US\$20 billion. Voting shares in the executive board reflect shareholder subscriptions, but power is said to rest with management rather than shareholders. There has been a persistent Anglo-Saxon business ethos.

The Bank's traditional concern with supply-side improvement of national economies (see SUPPLY-SIDE ECONOMICS) contrasts with interventions by its Bretton Woods partner – the INTERNATIONAL MONETARY FUND (IMF) – that invariably are demand restraining (see BRETTON WOODS SYSTEM). In the 1970s, the Bank's previous concentration on funding physical infrastructural projects was supplemented by rural development programmes in the context of a philosophy of meeting basic needs. A strong commitment to project evaluation revealed a need to address the macro-economic policy and institutional determinants of project performance. This, and the onset of the DEBT CRISIS in the THIRD WORLD in the 1980s, led the Bank to emphasize economic policy reform through conditionalities attached to quick-disbursing balance-of-payments finance, provided under STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) (see CONDITIONALITY). The Bank's neo-liberal agenda (see NEO-LIBERALISM) attracted sustained criticism on social, economic and political grounds, especially in the SOUTH. It responded by giving greater attention to the social dimensions of ADJUSTMENT and a renewed focus on POVERTY, through investments in primary healthcare and education, and social safety nets (as flagged up in its *World Development Report* of 1990). Left-wing critics say this is too little, too late, and maintain that social objectives should be a primary consideration in all of the Bank's thinking.

Following intensive lobbying by Western pressure groups (particularly in the United States) that were critical of the bad environmental record of large Bank-funded projects, the Bank introduced environmental assessment procedures in the second half of the 1980s.

While acknowledging there are still shortcomings, the Bank is now more cautious about (for instance) large dam and irrigation schemes that displace sizeable communities. Also, it makes increasing use of NON-GOVERNMENTAL ORGANIZATIONS (NGOs) as advisers and for implementing expenditure on immediate WELFARE and environmental objectives.

A major theme of the Bank since 1989 has been to improve clients' performance in GOVERNANCE, defined as the manner in which power is exercised in the management of economic and social resources for development. Good governance is viewed as synonymous with sound development management and is currently seen as essential to the success of programme lending. The Bank's approach is to extend technical assistance to capacity building in the institutions of good governance and to attach governance-related conditionalities to financial support. In addition to confronting the issue of military expenditure in several countries, specific concerns include public-sector management techniques, bureaucratic accountability, the rule of law and financial probity. Many analysts see all this leading to a further erosion of the SOVEREIGNTY of states, by making the Bank more intrusive than ever in the internal affairs of client countries. Moreover, while some commentators urge that lending to governments should now incorporate social conditionalities as well as (or instead of) economic and governance conditionalities, other analysts dispute the effectiveness of conditionality as a policy instrument. Informal cross-conditionalities with the IMF and bilateral aid agencies (see AID, BILATERAL), and the Bank's potential to influence as chair of donor consultative groups, provide no remedy. Analysts argue the Bank should move to a genuinely collaborative dialogue with borrowers, so as to encourage in them a greater ownership of prescribed solutions to economic problems and deeper commitment to the implementation of policy reforms.

A significant factor behind the Bank's several changes of approach to development is said to be its ambition to be the most

world city

important development institution and to play a hegemonic role in the donor community. Its reputation for intellectual leadership in economic policy analysis is unmatched. But its future profile as a lender looks uncertain in the face of the resumption of private resource-flows to emerging economies and influential voices urging that IFC lending on non-subsidized terms to private enterprise should supplant IDA lending to governments. Criticism persists in US circles especially of the Bank's record of managing internal change, excessive bureaucracy, absence of cost-consciousness and, for many years, lack of openness or transparency. The Bank's leadership faces a major challenge in the attempt to replace an entrenched culture that rewards officers for moving money, by an effective concentration on sustainable, poverty-reducing growth as the key test of Bank activities.

See also:

aid: aid, multilateral

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PETER BURNELL

world city

The notion of a 'world city' is an old one, dating back to the early twentieth century and before. The term was first made famous by writers like Patrick Geddes, for whom the term referred to giant 'conurbations' like Paris, Berlin and New York – city-regions that controlled the world economy. In the 1960s, the concept was taken up and dusted down by Jean Gottman and Peter Hall to refer to the main urban centres of administration and international trade.

It was, however, in the 1980s that the idea of the world city really came into its own, as the result of renovations by Saskia Sassen and Manuel Castells that explicitly linked the world city into the tradition of international political economy (IPE). World cities, now referred to as 'global cities', were reinterpreted as being in the vanguard of GLOBALIZATION. Cities like New York, London and Tokyo were to be regarded as the command and control points of the global economy within which the major economic functions were increasingly concentrated. These cities are the spaces where the business of global economic governance is carried out through an interlocking assemblage of business headquarters and financial markets, highly specialized financial and other professional services, elite labour forces (which might even be the beginnings of a nascent international professional class) and high-value commercial property markets. As spaces of constant crossing and interchange, they are the spaces within which information technology investment is concentrated (making them the key nodes in Castells' 'space of flows') and also, because of the demand created by the high incomes of so many professional workers, these cities also function as cultural innovators.

Some writers have argued that these cities have become such crucial elements of the

global economy that they may well be transformed into a new set of city-states that, because of their vaulting economic power, are able to become virtually independent of the NATION-STATE system. Other writers think this kind of speculation is overwrought. They see the discourse of world cities as simply another seductive lullaby of capitalism which is further tainted by a barely concealed eurocentrism.

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NIGEL THRIFT

world classes

'World classes' were first identified by Friedrich Engels and KARL MARX in *The Communist Manifesto*, where they wrote of CLASS STRUGGLES between 'Freeman and slave, patrician and plebeian, lord and serf, guild-master and journeyman, in a word, oppressor and oppressed' (Engels and Marx, 1959 [1848]: 1). The two great classes in conflict across the world are always, in this view, society's productive workers and the owners of its means of production, who extract surplus labour from them.

A world class is the same in principle as a local class. That is. it is a social group with common material interests (for example, income from profit or some other privilege of

property right) which is in conflict with another social group's common material interests (for example, income from wages or other means of life in return for service). But a basic question arises here: Where do modern world classes who receive no money in return for their labour services fit into modern economic models which only factor in monetized exchanges? A limitation of modern-class analysis of most Marxian as well as classical political economy has been an exclusive focus on classes within the money economy. (NEO-CLASSICAL ECONOMICS goes further and excludes the concept of class as such.) This narrow conceptual compass rules out such basic economic classes as non-waged women, subsistence farmers and indigenous peoples. Since the resources and work of these classes may yield more productive value than those within the monetized economy – and be more extremely exploited in exchange-value terms – this confinement of class analysis to the money economy has been increasingly challenged by feminist and indigenous theorists. The theoretical closure to non-revenue classes is most dramatically exposed at the global level where – unlike industrial societies – the great majority of the productive population are excluded by it. Because their productive and reproductive functions receive neither wages nor profits, they are ruled out as classes and class agencies as long as analysis remains confined within a monetary economic model. In this way, the dominant paradigms of both classical and Marxian political economy arguably exclude most of the planet's labour factors of production from their explanatory frameworks. These theoretical blinkers, in turn, can remain unremarked only so long as the world classes of unwaged women, subsistence farmers, indigenous peoples and working children are assumed to have no economic interests of their own that are in conflict with the revenue-receiving classes who subjugate them.

As the concept of world classes is progressively released from the confines of an exclusively monetary paradigm, the dominant model's restricted parametric of money cost,

world culture

price and profit is exposed as inadequate to economic reality.

See also:

Marxian economics

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JOHN McMURTRY
TERISA E. TURNER

world culture

To identify a 'world culture' is to assert the emergence of certain common social texts, practices and norms globally. Accounts of GLOBALIZATION include claims for a level of cultural artefacts and practices that are manifest at the global level. This is sometimes termed the 'McDonaldization' of the world, linking it to the development of global brands. Certain names are recognized and accorded status throughout the global system: perhaps the clearest example of this is *Coca-Cola*. This commercial understanding of culture complements a more ideological definition. Using the increasing incidence of political LIBERALISM, a world culture based on the shared (or imposed) norms of CAPITALISM may be said to be emerging. NEO-GRAMSCIANISM suggests the appearance of a global ruling class, whose cultural values inform this emergent world culture and are becoming a globalized 'common sense'. But the increased diffusion of cultural artefacts and forms (world music, ethnic crafts and textiles, developing country authors and even tourism) has brought with it a perception of a single world metaculture, made up of a mosaic of differing localized cultures whose products are available throughout the world market. Therefore the recognition of a world culture is linked closely to the

emergence of a global market for exchange goods and, as such, may exempt certain less tangible aspects of culture.

See also:

culture, economic role of; knowledge structure

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CHRISTOPHER MAY

world economy

The term 'world economy' is used to describe all trade relations and movements of capital between geographical units. The world economy can be understood as a system of rules, organizations and institutions that regulates world economic relations. These institutions are either private, inter-state or transnational organizations or institutions – for example, the INTERNATIONAL MONETARY FUND (IMF), the WORLD BANK, MULTINATIONAL CORPORATIONS (MNCs) or the WORLD TRADE ORGANIZATION (WTO).

In a theoretical discussion on world economy according to the realist approach to international relations (IR) and international political economy (IPE) (see REALISM), the world is a competitive STATE system. In this system, states stand in a continuous struggle for power, acting on the international market for their own interests. The restructuring of the world economy from the 1970s has led to a revision of theoretical approaches towards the understanding of world economic relations.

The neo-realist approach (see **NEO-REALISM**) accepts a hegemonic power within the world economy as a result of the sharing of power between states. However, it still considers states to be the main actors in international economic relations.

According to **WORLD-SYSTEMS THEORY**, the world economy is an entire world capitalist system that emerged in the sixteenth century with the rise of **CAPITALISM**. Although strong states are still the main actors in reproducing this system, its boundaries are not found to be in the reach of political power, but rather limited by the reach of trade relations.

In contrast to world-systems theory, **NEO-GRAMSCIANISM** states that the world economy was not expansive before the nineteenth century. The state system that emerged in the fifteenth century in Europe laid the basis for the world economy to become a dynamic and independent force. However, during this mercantilist era (see **MERCANTILISM**), it was constrained by national boundaries, national monopolies and trade restrictions. By the mid-nineteenth century, the world economy had developed into an autonomous force and had started itself to constrain state policies. From the mid-twentieth century onwards, two main processes were initiated that expanded both the breadth and depth of the global economy: (1) the **INTERNATIONALIZATION** of production and finance, and (2) the internationalization of the state.

See also:

world system; world market economy

MEHDI PARVIZI AMINEH

world empire

The term 'world empire' is used in two distinct ways. First, it is used to refer to the so-far unachieved total control of the globe by a single empire. Although the nineteenth-century European empires between them controlled much of the world, even the largest (the British

Empire – see **EMPIRE, BRITISH**) controlled only approximately a third of the globe at its greatest extent. The second sense is specific to **WORLD-SYSTEMS THEORY**, as propounded by **IMMANUEL WALLERSTEIN**. It refers to the regional economic control exercised by large empires prior to the formation of the modern **WORLD SYSTEM**, which occurred in Wallerstein's view around 1500 AD. Here 'world' is used (as in 'world-systems analysis' or 'world-systems theory') to designate a set of economic relationships that is not geographically bounded. In this sense, world empires would include the Roman and Chinese empires, but not the British Empire of the nineteenth century. The term 'world empire' is not used by all those employing the concept of the world system, as some scholars (especially Barry Gills and **ANDRE GUNDER FRANK**) working within this framework hold that there has only ever been a single world system, which originated in the Bronze Age Aegean. In their understanding of the world-systems approach, there is no place for the world empire in Wallerstein's sense of the term.

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KEN DARK

World Health Organization (WHO)

The World Health Organization (WHO) became operational in 1948 as a specialized agency of the **UNITED NATIONS (UN)**. It is one of the most global of international agencies, having 191 member-states in 1998. The WHO headquarters are in Geneva and there are regional offices around the world. While the WHO is concerned with health issues

World Intellectual Property Organization (WIPO)

in general, its self-defined major functions are to give worldwide guidance in the field of health, to set standards for global health, to cooperate with governments in strengthening national health programmes, and to develop and transfer appropriate health technology.

ANDREW M. SHERRIFF

World Intellectual Property Organization (WIPO)

The World Intellectual Property Organization (WIPO) was established by a convention in 1967, effective from 1970, to promote the international protection of intellectual property. An agency of the UNITED NATIONS (UN) since 1974, WIPO has its roots in the 1883 Paris Convention for the Protection of Industrial Property and the 1886 Berne Convention for the Protection of Literary and Artistic Works. These conventions' secretariats were amalgamated in 1893, finally becoming WIPO. WIPO also administers other international treaties covering intellectual property and is responsible for promoting TECHNOLOGY TRANSFER by supporting the recognition of INTELLECTUAL PROPERTY RIGHTS (IPRs) in DEVELOPING COUNTRIES. In 1996, dispute settlement in this area passed to the WORLD TRADE ORGANIZATION (WTO).

See also:

patents; Universal Copyright Convention (UCC)

CHRISTOPHER MAY

world market economy

The term 'market economy' is often used to refer to an economy in which goods and services are allocated primarily through the mechanism of the market – that is, through the free interaction of buyers and sellers who make

decisions based on a freely determined market price for the good or service in question. In reality, no economy in the world relies on the market to allocate or reallocate all the resources within the economy. Some portion of GROSS DOMESTIC PRODUCT (GDP) is provided either free of charge or at a subsidized rate through the STATE and financed out of taxation. Where the state plays the leading role both through ownership of the major parts of the economy and through decisions made at a centralized level within the context of a plan for the economy as a whole, the economy is variously described as a 'centrally planned economy' or 'state-controlled economy' (see COMMAND ECONOMIES).

The term 'world market economy' is generally used to embrace only those economies that rely primarily on markets and generally excludes the centrally planned ones. With the collapse of the communist bloc in Eastern Europe, the number of centrally planned economies is now relatively small. China, North Korea and Cuba are perhaps the most obvious examples, although, in recent decades, the market economy within China has grown at a rapid rate.

See also:

capitalism; communism; socialism

NIGEL GRIMWADE

world order

A 'world order' is a construct of norms, values and international codes of conduct in the form of legally binding principles, standards and institutions that regulate and are regulated by states and TRANSNATIONAL ACTORS. However, these rules cannot be separated from the regulating forces within the global economy: socioeconomic factors, the development of technology, the international power structure, the character and intensity of international cooperation and the management of international institutions.

Furthermore, in an interconnected system there are always processes that cannot be predicted. Therefore, these regulating forces are stable only to a certain extent. Neither can a world order be considered as static: its predominance is subject to a complex of changes.

Since the 1970s, political scientists have become aware that NATION-STATES are faced with a number of problems politically, economically, ecologically and militarily, that cannot be reduced to the individual state – which is the main analytical unit for the Realist School (Carr, 1981 [1939]; Morgenthau, 1973; see REALISM) – but have a global dimension that can only be dealt with internationally. The INTERDEPENDENCE model of the neo-realist school (Gilpin, 1987; see NEO-REALISM) still considers the nation-state as the main actor in international relations (IR). Economic and social questions are still dominated by national security problems. However, they agree that there are also inter-state and transnational actors that have to be taken into account on the international political scene. Internationally set rules and regulations could provide some form of order in this anarchic inter-state system. States that do not act in accordance with these rules could be sanctioned by a legitimately established international authority.

The world-systems theorists – especially IMMANUEL WALLERSTEIN (1974; see WORLD-SYSTEMS THEORY) – reject the state-centred approach of the neo-realist school. According to the world-systems view, the world does not consist of independent nation-states but of one capitalist world system which is held together by an international division of labour (see DIVISION OF LABOUR, INTERNATIONAL). Political structures, states and classes are determined by the structure of this WORLD SYSTEM. Classes exist within a world system. They construct state apparatuses to institutionalize their power and to be able to intervene in world markets. Structures of state and class are thus products of the world system and their conflicts are subordinate to the structure of the world economy.

Both neo-realist theory and world-systems theory have been criticized for their relatively static approach by adherents to NEO-GRAMSCIANISM. Following ANTONIO GRAMSCI, ROBERT COX (1987) developed a new ontological approach to international political economy (IPE). Gramsci used the notion of HEGEMONY to distinguish between the forms by which power is exercised in different national societies. Cox has made use of this Gramscian notion to describe power relations on an international level. A ‘world hegemony’ or ‘hegemonic world order’ is the expansion of a national hegemony at a global level. Cox distinguishes between three historical structures of world order that have arisen in the last two centuries (namely, the hegemonic world order of the *PAX BRITANNICA* from 1789 to 1873; the non-hegemonic world order of rival imperialisms from 1873 to 1945, and the global hegemony of the United States or *PAX AMERICANA* of the post-war era). He writes:

Each successive structure of world order was characterised by the emergence of new forms of the state, new historical blocs, and new configurations of the production relations.

(Cox, 1987: 109)

According to this approach, the world order is not understood as a static system, but as subject to structural change due to state transformations and changes in the relations of production

See also:

Carr, E(dward) H(allett); Gilpin, Robert; hegemonic stability; hegemonic stability theory; imperialism

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world powers

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MEHDI PARVIZI AMINEH

world powers

'World powers' are actors that are able to shape international affairs. At the end of the twentieth century, the variety and number of world powers, and the means by which they influence events, is greater than ever before.

Traditionally, world powers have been particularly important states (see STATE, THE), often imperial powers like Great Britain in the nineteenth century and the United States in the twentieth (see IMPERIALISM). World powers have sometimes been identified by region. Thus we might refer to Europe and North America as being among the world's most important powers. Increasingly, references are made to the EUROPEAN UNION (EU) or the NORTH ATLANTIC TREATY ORGANIZATION (NATO), showing that regional organizations can be identified as world powers. Other governmental organizations can act as world powers as well – much as the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) did in the 1970s. Many people hope that the UNITED NATIONS (UN) will one day be a world power.

Increasingly non-governmental actors have become world powers. This is especially true of MULTINATIONAL CORPORATIONS (MNCs). Indeed, some MNCs have more economic and even political power than many of the world's

governments. Furthermore, one might even argue that some individuals have become world powers because they are able to shape people's thinking and the behaviour of other international actors. One might place Bill Gates, founder of the *Microsoft* computer software giant, in this category, along with Rupert Murdoch, who controls much of the world's media.

While world powers are able by definition to coerce or persuade other international actors to behave in ways that they prefer, their power can be limited. This is especially evident when world powers overextend themselves, as has happened with many empires through history (see OVERSTRETCH THEORY). World powers can also be challenged by the cunning use of power by nominally weak powers, as demonstrated by the US defeat in the Vietnam War. Presently, world powers such as the United States or the EU are finding that their influence is limited by the decentralized forces of economic GLOBALIZATION.

See also:

hegemony; power

PAUL G. HARRIS

World Radiocommunication Conference

Under major reforms of the INTERNATIONAL TELECOMMUNICATION UNION (ITU) in 1992, the functions of the old WORLD ADMINISTRATIVE RADIO CONFERENCE (WARC) were transferred to Radiocommunication Conferences, which were to be held at world level at two- rather than twenty-year intervals. The old International Frequency Registration Board was also succeeded by a new Radio Regulations Board.

JOHN VOGLER

world state

Ancient Stoic thought held that, by design, the universe is a city and all people are its citizens. Early modern Europeans interpreted the cosmopolitan idea as natural LAW, forming a world republic of many republics. Christian Wolff's *civitas maxima* and the *civitas gentium* of IMMANUEL KANT capped this way of thinking, which avoids the language of STATE and SOVEREIGNTY. Under the influence of positivist conceptions of law and the state (see POSITIVISM), progressive liberal thinkers in the nineteenth century held that a world federal state was necessary for peace. They also believed that legal-institutional developments pointed towards its eventual triumph. As a popular movement, world FEDERALISM grew stronger in the aftermath of World War I, only to be dashed by World War II and the rise of REALISM. The last great effort to plan for a federal world state based on liberal institutions was Grenville Clark and Louis Sohn's *World Peace through World Law* (1996). It used the Charter of the UNITED NATIONS (UN) as a template. Sympathetic critics responded with a variety of decentralized WORLD ORDER models. The progressive view today that sovereignty is in retreat, and deservedly so, suggests that world state advocacy is not likely to be resumed soon.

See also:

governance, global

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NICHOLAS ONUF

world system

WORLD-SYSTEMS THEORY suggests that there is a single capitalist world economy or 'modern world system' that largely determines international affairs. All social events must be examined in the context of the world system. The underlying capitalist structure of the world shapes the global political economy and determines who will be 'winners' and 'losers'. It results in a global system of regional 'class divisions'. Thus, in so far as there is a CLASS STRUGGLE, it is not between workers and capital but between rich countries and poor countries.

The capitalist system, which formed during the fifteenth century, is manifested by a global division of labour between industrialized, developed 'core' states of the North and non-industrial, developing 'periphery' states of the SOUTH. During the INDUSTRIAL REVOLUTION, the core states traded their manufactured goods for the peripheral states' basic commodities (for example, minerals, agricultural products), much as many states still do. This system of unequal exchange was guaranteed by colonial domination of the periphery by the core (see CORE-PERIPHERY MODEL). The core's ability to dominate the periphery derives from the wealth it earns at the expense of the periphery. In short, there is a global 'class system', with the developed states exploiting the developing states. COLONIALISM has been replaced by NEO-COLONIALISM.

The global system is one of the concentric circles of power or overlapping hierarchies. This obtains everywhere; thus there are core and periphery areas within core states – London compared to the north of England –

and likewise in the periphery states – Shanghai and Hong Kong contrasted with rural China.

World-systems theory mirrors in some ways the views of LENIN ON IMPERIALISM. He argued that the world was divided into core and periphery economies, with the core being capitalist. The capitalist core squeezed the periphery to make super profits, which were then used to pacify workers in the core. While this view was popular in the East, especially before World War II, its effect on contemporary world-system thinkers is marginal. What neo-realists describe as international anarchy, world-system theorists argue is the structural dependency of the periphery on the core (see ANARCHY, INTERNATIONAL; NEO-REALISM). When great-power wars are fought, they are caused by competition over which core states will be able to exploit peripheral states.

Until quite recently, core states were exclusive producers of the most modern, technologically advanced products, using sophisticated engineering methods and capital-intensive manufacturing processes that require highly skilled, well-paid workers. By contrast, peripheral states have until recently – as many still do today – specialized in technologically unsophisticated and labour-intensive products or in basic COMMODITIES that require little capital – and pay very low wages. Combined with their military inferiority relative to the core states and their relatively inefficient governmental organizations, these factors made it difficult for developing states to compete with the developed states.

The emergence of the so-called ‘Asian tiger’ NEWLY INDUSTRIALIZED COUNTRIES (NICs) (namely, Hong Kong, Singapore, South Korea, Taiwan) and the industrialization of much of the South, challenged the world-systems approach. Thus theorists developed the notion of the SEMI-PERIPHERY, where some industrialization occurred and some wealth accumulated. These states, they argue, while undergoing industrialization are nevertheless still dependent on the core for financing and new technologies. Such a scenario is exacerbated because elites in developing countries are said

to conspire with elites in core countries (as seen, for example, in Russia).

This does not mean that peripheral states cannot, in time, join the core states. This is precisely what happened with the United States. China appears to be well on its way into the semi-periphery. What is more, core states can deteriorate and subside into the periphery – this happened to Portugal, at least in comparison to its imperial past.

An important feature of world-systems theory is that it highlights the huge disparities in wealth and well-being between the industrialized countries of the North and the South. Core states are characterized by democratic governments, high wages and well-developed social WELFARE systems. States in the semi-periphery usually have authoritarian governments, low wages and limited welfare. The states of the periphery are worst off, with non-democratic governments, wages that do not meet or barely meet subsistence needs and an utter lack of government welfare. Most world-systems theorists would maintain that these disparities are a result of the industrialized countries’ exploitation of the developing countries. In short, the comfortable lifestyles of people living in the North come at the expense of the South – and indeed exacerbate poverty and suffering there. Such disparities are only getting worse. According to the *Human Development Report* (1998: 29–30), in 1960 the 20 per cent of people who lived in the world’s wealthy countries had thirty times the income of the world’s poorest 20 per cent, but by 1995 the former had 82 times as much income as the latter. The report also points out that the world’s 225 richest people – most of them living in the ‘core’ states – have a combined wealth that exceeds US\$1 trillion, which is equal to the annual income of nearly half the world’s population (2.5 billion people). A mere 4 per cent of the richest 225 people’s wealth would be enough to provide universal access to basic education, basic healthcare for all, reproductive healthcare for all women, adequate food for all, and safe water and sanitation for all.

Critics of the world-system approach argue that it is too simplistic, underrating the

importance of the 'periphery' for the 'core', failing to account for the economic successes of many developing countries and disregarding the importance of NON-GOVERNMENTAL ORGANIZATIONS (NGOs), regimes and individuals in shaping international circumstances.

See also:

capitalism; imperialism; Marxism–Leninism

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PAUL G. HARRIS

world-systems theory

World-systems theory draws on the intellectual tradition of MARXISM–LENINISM in focusing on the structures of dominance and depen-

dence in the international system. Although MARX was regarded as having taken too little account of the international system in his analyses, LENIN overcame this omission in his explanation of IMPERIALISM and the acquisition of colonies as an extension of the growth of CAPITALISM. Marxism–Leninism developed, however, and as it did so the impact of imperialism on LESS-DEVELOPED COUNTRIES (LDCs) became more significant as an issue of debate. Analysts concentrated on the question of UNEVEN DEVELOPMENT between those states seen as exploited and those states seen as the exploiters and, along with DEPENDENCY THEORY, world-systems theorists appeared to offer a reason for the increasing inequalities between countries in the North and countries in the SOUTH.

World-systems theorists, then, view the current international system in similar terms to dependency theorists, with an emphasis on the international division of labour prevailing in what world-systems theorists perceive as an international system that is predominantly capitalist and hence exploitative in structure (see DIVISION OF LABOUR, INTERNATIONAL). For world-systems theorists, the key actors in the international arena are not states, but the classes that are involved in this prevailing capitalist structure (and in the fight to overthrow it) – the exploiters and the exploited. The key issues are thus the inequality and EXPLOITATION that such a system is seen to create. Moreover, because the prevailing capitalist system is perceived in this manner, world-systems theorists believe that there is a significant possibility that this system will undergo a transformation at some point in the future. This idea is akin to Marx's notion of the eventual overthrow of the capitalist system as a result of CLASS STRUGGLE.

Hence, in contrast to more traditional theories of international relations (IR) that focus on the nature of conflict and its resolution in the international system, world-systems theory focuses on issues such as POVERTY and the nature of DEVELOPMENT, and why that development is so often uneven. In this, world-systems theory analyses the global order at

both the domestic and international level of analysis, with the politics of the state being seen as the principle linkage between the two. In this way, it is not so much the international global structure in and of itself that is important, but the politics that takes place within it.

However, unlike dependency theory which emphasized a bipolar international structure, focusing on a relationship between developed and underdeveloped states in which SURPLUS VALUE is transferred from a dependent periphery of developing countries to a dominant core of industrialized ones, world-systems theory extends the analysis. World-systems theory thus argues that such a bipolar framework is too simple, particularly given that it could not explain why industrialization had actually taken place in some formally underdeveloped states, such as the Asian Tigers (see FOUR TIGERS (ASIAN)) and Brazil. For this to be understood, the international system (world-systems theorists argued) had to be perceived as an complex network of political, economic and cultural interactions. In particular, world-systems theory recognizes the existence of a class of states that exist between the core and the periphery (see CORE-PERIPHERY MODEL). This 'middle-class' of states was termed the 'SEMI-PERIPHERY' by IMMANUEL WALLERSTEIN (the analyst who has clarified much of the world-systems theory approach). This semi-periphery was seen as necessary for the economic growth and political stability of the system as a whole, situated as it was between the core and periphery in terms of economic power. Semi-peripheral states have societies that are in the process of industrializing and diversifying their economies. Wallerstein argued that there were limited opportunities for upward movement within the capitalist WORLD SYSTEM and, under such circumstances, industrialization was the only way for states to move to the core. World-systems theory, then, provides an explanation for the industrialization that has taken place in some of the former LDCs. In addition, semi-peripheral states play a critical role in the world system because their existence means that the core states are not constantly pitted against the periphery states.

Indeed, Wallerstein attributes the survival of the system to the existence of these semi-peripheral states, arguing that they have acted as a cushion between the exploiting core states and the exploited periphery. The semi-peripheral states do this because, by playing the role of both exploited and exploiter, they diffuse both the anger and revolutionary activity of the peripheries. Indeed, Wallerstein sees the semi-periphery as a structural prerequisite for stability in the international system. When and if this ceases to be the case, then the international system will disintegrate. Thus, all countries are fundamentally and inescapably constrained, Wallerstein argues, by the international system as a whole. Moreover, the semi-periphery provides secure INVESTMENT locations for core capital whenever core wages become inflated by well-organized labour movements.

One aspect of Immanuel Wallerstein's work not mentioned so far, but that is crucial to his conception of world-systems theory, is the role of history. Wallerstein argues that in the course of world history there have been two types of world system. First, there have been WORLD EMPIRES, where the structure of the international political system basically coincides with the structure of the international economic system. Second, there have been world economies (see WORLD ECONOMY), where the structure of the international economic system contrasts with what he sees as the highly diverse political system that independent sovereign states inhabit. In a series of seminal articles, Wallerstein took a long-run view of the existing international system, arguing that the extensive capitalist global economy that exists today has been under development since the middle of the fifteenth century. Over four centuries, the expansion of world trade, alongside the collapse of world military empires such as those previously held by Spain and Portugal, has resulted in a global historical progression that has led us to the world system that exists today. Thus, for Wallerstein, the dynamics of the contemporary world system are provided by the long-term nature of the world economy. We therefore have a system, Wallerstein argues,

characterized by a single division of labour that is producing for a world market. Nation-states are thus mutually dependent on successful economic exchange, with goods being sold for the maximum profit, and the world is divided into three areas; this division corresponds to the role that nations within each of these areas play in the international economy – namely, Wallerstein's notions of the core, the periphery and the semi-periphery. Wallerstein further concluded that a world division of labour based on trade relations has historically given rise to regional economic specialization and to an international structure of unequally powerful nations. Particular states have become increasingly used to securing favourable TERMS OF TRADE, through measures that include military threats and interventions. The tendency of politics to serve economic ends has thus accelerated the unequal distribution of wealth within the global system. For this reason, the capitalist system became increasingly polarized into a core of wealthy, technologically advanced countries and a periphery of poor countries from which key primary goods and capital were extracted on unfavourable terms. Thus, core countries enjoyed a position of global dominance as the result of their structural relations within the world economy, a position that helped to sustain a constant accumulation of new advantages by the core nations. Likewise, peripheral countries encountered structural constraints on their political economies that prevented there being any fundamental change in their disadvantaged positions. For this reason, uneven development was endemic within the capitalist world system.

Moreover, it is important to note that Wallerstein included the socialist and communist countries in his conception of the world capitalist system (see COMMUNISM; SOCIALISM). He reasoned that while the absence of private ownership of the means of production in some countries resulted in internal reallocations of consumption, these nations' enterprises still participated in and conformed to the pressures resulting from the nature of global capital markets. That is, even the socialist economies want increased efficiency in their production in

order to realize maximum prices for their products. Through this they achieve a more favourable allocation of the benefits that the world economy has to offer. Moreover, because the socialist countries are part of the structure of economic trade relations with other countries within the world system, they are part of the world division of labour and thus occupy a particular position within the capitalist world system. In the creation of this unified world economy, labour is organized on a global basis while capital, in the form of profits, accumulates in the more advanced countries. Physical production remains in a less advanced periphery. Core societies are thus more likely to be wealthy and economically diversified, while peripheral societies are economically weak and more subject to direct intervention and manipulation by the core. The global division of labour thus stems from the UNEQUAL EXCHANGE of basic commodities.

The result of this dichotomy is not only an ever-widening gap between the core and the periphery, but also the creation of dependency of the periphery on the core that the former finds difficult to overcome. This is further reiterated by the fact that the class structure within the core, characterized by an ever-widening gap between labour and capital, is repeated within the periphery. The result of this is that elites in both the core and the periphery have no incentive to seek to transform the existing system and the inequality remains.

One of the major benefits of using a world-systems approach is that it takes into account a long-run historical perspective on world affairs rather than merely focusing on what is occurring in contemporary society. There are, however, a number of criticisms that can be made of the world-systems approach. The first is that the notion of the semi-periphery and its dynamics is often vague. Such a criticism could be overcome by ensuring that a full analysis of the actual role of the state is undertaken, however this is often not done. Indeed, world-systems theory neglects – or at least often pays little attention to – the role of the state and, in particular, the dynamics that arise from the efforts of the state to deal with issues of

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security in the international system. For example, Wallerstein discusses the kind of strategies that a state would use in order to move from the semi-periphery to the core. In doing so, he makes specific assumptions regarding the amount of autonomy that such a state has in its policy-making. Such assumptions basically rely on the idea that a state will have a high level of autonomy over its policies if it is economically successful and vice-versa. Critics of world-systems theory have, however, demonstrated that this is not always the case.

A second criticism is that the concept of a world capitalist system is central to these models, but its relevance for much of the twentieth century can be questioned. A state's position within the international system has important consequences for its development. However, world-systems theory (as well, indeed, as dependency theory) does not contain enough rigorous formal hypotheses to be capable of adequate empirical test. Instead, researchers tend to stress the varying consequences of nations' positions in the international order for economic growth, foreign investment, the penetration of MULTINATIONAL CORPORATIONS (MNCs) into an economy, profits, income inequality, occupational distributions, political instability and violence, and other population indicators. Nevertheless, world-systems theory, by concentrating on the world system as a whole, can offer insights that other more narrow theories cannot, and for this it must be considered useful.

See also:

Brandt Report; interdependence; structuralism

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World Trade Organization (WTO)

The World Trade Organization (WTO) is the multilateral organization charged with managing trade relations among its more than 130 members. The WTO is the successor organization to the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT). Negotiated in 1948, the GATT was intended as a provisional tariff-reducing trade agreement pending the creation of an International Trade Organization (ITO). The failure of the United States to ratify the agreement creating the ITO led to its demise and left the GATT to function as a *de facto* trade coordination body. The contracting parties or members of the GATT met eight times in multilateral trade negotiations or GATT 'Rounds', drafting further agreements to reduce tariffs and regulate non-tariff trade measures and policies. In the final round of the GATT, the URUGUAY ROUND (1986–94), negotiations on the functioning of the GATT system led to the creation of the WTO, which came into being on 1 January 1995. The body of international trade law negotiated in the GATT Rounds was incorporated into the WTO. With some exceptions, members who join or accede to the WTO agree to this entire body of trade law. The WTO continues to sponsor multilateral trade meetings, draft trade regulations, manage trade disputes, and promote predictable and transparent trade policies.

Several principles are integral to the WTO management of world trade. Principles of transparency and predictability emphasize the need to make trade rules clear and consistent, so that traders can plan transactions. Liberalization and increased competition are impor-

tant principles that motivate the reduction of **TARIFFS** and the reduction of **NON-TARIFF BARRIERS (NTBs)** to trade. Trade liberalization and concessions are to be offered on a non-discriminatory basis (see **LIBERALIZATION OF TRADE**). Non-discrimination through the 'MOST FAVOURED NATION' principle means that concessions given to one WTO member are available to all other members. 'NATIONAL TREATMENT' further ensures that like products receive the same treatment, regardless of whether they are imported or domestic products. Two other principles are in direct tension with, respectively, the liberalization and the non-discrimination norms. The safeguard norm allows states to halt trade liberalization when domestic industries face severe injury. The development norm allows for discriminatory trade treatment in favour of the **LESS-DEVELOPED COUNTRIES (LDCs)**. These conflicting principles represent the tensions involved in multilateral trade management.

At least every two years, the WTO meets at the ministerial level in a Ministerial Conference, which is the highest level of authority for the WTO. The day-to-day operations are conducted by the heads of national delegations meeting as the General Council. The General Council meets in the WTO headquarters in Geneva several times a year. Members of the General Council also function as the Trade Policy Review Body and the Dispute Settlement Body. Reporting to the General Council are the Goods Council, the Services Council and the Intellectual Property Council. These councils conduct work through various committees, working groups and working parties which deal with more specific functional areas.

The work of the WTO is supported by the WTO Secretariat, whose headquarters are in Geneva, Switzerland. The WTO Secretariat is headed by a Director General and four Deputy Director Generals, who oversee the work of approximately 500 staff members. The budget of the WTO is made up of contributions from the members, based on their share of the total trade conducted by WTO members.

While the work of the WTO in sponsoring multilateral trade negotiations carries on the

work of the GATT Rounds, the WTO also conducts less publicized activities on an on-going basis. The WTO assists developing economies and the economies of states in transition towards a market-based system with their trade concerns, particularly through the training of officials. In cooperation with the **UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD)**, the WTO assists the promotion of developing country exports through the International Trade Centre. The WTO is charged with coordinating economic policy-making with the **WORLD BANK** and the **INTERNATIONAL MONETARY FUND (IMF)**. The WTO operates as a clearing house where all members must notify the WTO of new or modified trade measures. The General Council, acting as the Trade Policy Review Body, also conducts periodic reviews of the trade policies of all WTO members.

The WTO includes a dispute-resolution mechanism over which no member has a veto. While the GATT also had a dispute-resolution system, disputes could be prolonged and a member could block any finding that it violated GATT rules. The WTO dispute-resolution procedure includes fixed timetables for the various steps in the procedure, leading to a maximum of approximately fifteen months for a dispute to go through the procedures. The General Council functions as the Dispute Settlement Body (DSB) which oversees the dispute procedures. The procedures include the submission of a dispute, the selection of a panel to hear the dispute, submission of the panel's report to the DSB and the decision of the DSB to adopt the panel report. If there is an appeal against the panel report, the panel will hear the appeal and subsequently submit an appeals report to the DSB for adoption. What is particularly important is the fact that no party to the dispute can block or veto the adoption of the panel reports. Following a finding that a state has violated its WTO obligations, the parties seek to reach a remedy. If the state in violation does not comply with the remedy, the DSB may authorize limited trade sanctions against the state in violation. Trade conflicts are open to settlement through consultation

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outside the dispute-settlement procedure at any point.

Although the WTO has a strong dispute procedure relative to other multilateral organizations, it is not without critics. Concerns have been raised that where trade disputes also impinge on non-trade issues, particularly environmental policies, the panel members involved in dispute settlement are trade professionals and may not have expertise to address the non-trade-related implications. A more general criticism of WTO dispute settlement is the lack of transparency of the procedures. As of March 2000, some 190 disputes had been brought to the WTO.

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JANE WINZER

X

x-efficiency (XE)

The 'x' in 'x-efficiency' stands for a type of EFFICIENCY which NEO-CLASSICAL ECONOMICS assumes always exists: intra-firm efficiency. Accordingly, firms are assumed to minimize costs, to purchase and utilize all inputs efficiently. X-efficiency (XE) theory maintains that firms are internally efficient or x-efficient – achieving cost minimization – only when there is sufficient pressure for them to do so. Otherwise, sheltered from pressure, costs exceed minimum levels and they are x-inefficient. Neo-classical theory explains apparent deviations from cost minimization in terms of incomplete information or uncertainty facing decision-makers, transaction costs, PROPERTY RIGHTS or the utility gained by excess costs.

Conventional theory allows markets to be both efficient and inefficient. A market is efficient – allocative efficient – under PERFECT COMPETITION when firms price their output at marginal cost, and hence when the marginal benefits and marginal costs of the product are equal. This is called the 'socially optimum rate of output' (SORO). MARKET POWER results in the firm's price exceeding its marginal cost and

its output being less than SORO. This is called 'allocative inefficiency' or a deadweight WELFARE loss.

XE theory, developed by Harvey Leibenstein (1966), was motivated to show that protection from competitive pressure produces both allocative inefficiency and x-inefficiency. Extensive evidence covering a wide range of both firms and industries throughout the world shows that the (welfare) costs of x-inefficiency are large, exceeding those of allocative inefficiency.

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ROGER S. FRANTZ

Y

Yom Kippur War

The Yom Kippur War (also called the October War or the Ramadan War) broke out in October 1973 and was the fourth war in the Arab–Israeli conflict. The reasons for the war were the continued Israeli occupation of the Golan Heights and the Sinai Desert, and the stalemate in international mediation efforts.

The military initiative was led by Egypt's President Anwar Sadat and the new President of Syria, Hafez al-Asad. Military preparations in both Syria and Egypt, beginning in late 1972, were interpreted in Israel as simply part of military exercises. Israeli intelligence estimated that the Arab states were not ready to go to war. Egypt's and Syria's attempt to launch a surprise attack was therefore successful. On 6 October 1972, Egypt and Syria attacked simultaneously on the southern and northern front respectively. The attack occurred on the Day of Yom Kippur, when in Jewish tradition the day of atonement is celebrated.

The Israeli armed forces were rapidly mobilized, but the initial days of the war led to heavy Israeli losses. Israel's first counter-attack came on 8 October, but the Egyptians continued to make progress. Due to the lack of effective air defence to support a major attack, Egypt did not proceed to launch any major military offensive during this stage of Israeli disarray. On 14 October, the Egyptians did launch a larger operation, mainly in order to satisfy the Syrians who had expected the

Egyptians to move further eastwards. By now, Israel had got its defence in order and their luck had changed. In the following days, the Israelis proceeded to establish their presence on the Suez Canal. The Israeli air force also regained its superiority.

On 16 October, the Arab oil producers raised the oil prices and reduced oil production, in order to sustain the Egyptians and Syrians.

The war lasted for two weeks, sustained by the SUPERPOWERS, who assisted their respective allies with major arms supplies. At the same time, both the United States and the Soviet Union worked for a ceasefire in the UN Security Council (UNSC). On 21 October, the UNSC agreed a ceasefire, but the combatants did not comply with their decision. The decision was reiterated on 22 October, accompanied by UNSC Resolution 338. On 24 October, the Soviet Union threatened military intervention, putting US forces (including their nuclear capabilities) on high alert. The world was dangerously close to a Third World War. On 24 October, the war came to an end.

Although the war initially brought considerable Israeli losses, by the end of the conflict it seemed that Israel had gained a victory. However, the surprise attack and the initial progress by Egyptian and Syrian forces had been a shock to Israel: the war had shown that it was possible to challenge Israel's military strength.

HELENA LINDHOLM SCHULZ

Z

Zapatista Rebellion

The Zapatista Rebellion took place on New Year's Day 1994, when 600-1,000 peasant soldiers of the Zapatista Army of National Liberation (EZLN) captured four towns in the impoverished southern state of Chiapas, Mexico and held them for several days. The assaults were timed to coincide with the formal launch of the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) in order to gain maximum media attention, embarrass the Mexican government and discredit the trade agreement.

Like leftist rebellions elsewhere in Latin America, the origins of the Zapatista Rebellion were rooted in poverty, inequality and corruption. Rural residents of Chiapas are among the poorest in Mexico, despite the presence of substantial oil and natural gas in the area. Its heavily Indian population is dominated by landed elites, and its state and local governments are repressive and corrupt. Zapatista demands, however, were unique. The EZLN avoided traditional Marxist rhetoric; instead, they articulately exposed the deficiencies of the Mexican Revolution and called on the government to live up to its own ideals and promises.

Zapatista appeals to greater social justice and democratic reform resonated with ordinary Mexican citizens. In opinion polls, most Mexicans supported the goals of the EZLN, but disapproved of their methods. Even some opposition political parties expressed support for some of their demands. Zapatista popular appeal did not come from their numbers, however, for they were a small organization. Rather, it lay in their ability to expose the country's failures and the deficiencies of the Mexican Revolution. By calling themselves

'Zapatistas', they identified with Emiliano Zapata, whose legacy as a defender of social justice made him the most revered of the heroes of the Mexican Revolution.

After difficult negotiations between the government and the rebels, a provisional peace accord was announced that met most of the demands of the EZLN except those for political reform. The government promised to discuss political reform with the established political parties, not with the rebel movement. The EZLN responded by rejecting the peace accord, which led to public disenchantment with the rebels and declining interest in their campaign. But the questions raised by the Zapatistas about social justice and political reform remain a major challenge for the Mexican government.

WILLIAM P. AVERY

zero-sum games

A 'zero-sum game' is a strategic game in which gains received by a player or group players equal losses suffered by another player or group of players. Two-person zero-sum games, such as chess, are strictly competitive games in which cooperation between the players would be pointless.

Zero-sum games (one form of constant-sum games) were central to early developments in GAME THEORY and strictly competitive games figure prominently in textbooks, being easier to present elegantly. Increasingly, however, economic and political applications of game theory have turned to games in which the total value to all players depends on the outcome. For instance, in models of international

zero-sum games

conflict (such as arms race models), the players considered as a group are better off with an outcome of peace, not war. Games whose players derive pleasure from playing are also non-zero-sum games, with the players jointly benefiting from the game continuing.

Modern game theory begins with Zermelo's 1913 proof (later extended to all strictly competitive games of perfect information without simultaneous moves) that chess is strictly determined: there exists an optimal strategy that will force a particular result. (Fortunately for chess players, the strategy and outcome remain unknown.) Von Neumann's 1928 minimax theorem showed that, allowing mixed strategies (picking the probability of playing each pure strategy, rather than a single pure strategy), every two-person zero-sum game with finite numbers of pure strategies has only a single individually rational outcome: each player can achieve some expected value, whatever the other player does. Even though minimax and strictly competitive games are no longer at the centre of game theory, many vital elements of game theory grew out of such analysis, including extensive and strategic forms of games, randomization and dominant strategies.

See also:

tit-for-tat strategies

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